Alfred J. Blasco

BRANCH BANKING IN THE UNITED STATES

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IN
THE UNITED STATES

BY
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First Edition

McGRAW-HILL BOOK COMPANY, Inc.
NEW YORK: 370 SEVENTH AVENUE
LONDON: 6 & 8 BOUVERIE ST., E. C. 4
1928

PRINTED IN THE UNITED STATES OF AMERICA

THE MAPLE PRESS COMPANY, YORK, PA.

TO

MY WIFE

WINIFRED WEST SOUTHWORTH

PREFACE

Work on this book was begun in the summer of 1925, when the writer went to California to study the branch-banking situation there. In the summer of 1926, he visited Chicago, Detroit, Montreal, Quebec, Boston, New York, Philadelphia, Washington, and Pittsburgh, interviewing bankers and observing banking developments in those cities. His heartiest thanks are due the many busy bankers who granted him interviews.

Events have come in such rapid succession that continual revision of the manuscript has been necessary. The present tense has yielded to the past. The passage of the McFadden Act in February, 1927, stands as a landmark in American banking history and in the main this book is intended to portray the situation as it existed at that date though certain of the effects of that act are also considered.

The writer wishes to express his sincerest appreciation of the help given him by Professors F. A. Fetter and F. D. Graham of Princeton University, through their painstaking perusal of the original manuscript and critical suggestions for its improvement. To Professor E. W. Kemmerer the writer owes a great debt for his early instruction in banking principles. For courteous service in the provision of materials and facilities for the investigation upon which this book is based, the writer owes much to the libraries of the University of California, the University of Colorado, and the College of William and Mary.

SHIRLEY D. SOUTHWORTH.

WILLIAMSBURG, VIRGINIA,
March, 1928.

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INTRODUCTION

Branch banking is not new in the United States. From the incorporation of the first Bank of the United States, in 1791, until the Civil War, branch banking made its appearance in varying forms, under varying conditions, bringing into being varying problems; but from the Civil War until about 1900, the amount of branch banking carried on in the United States was negligible. Especially during the period 1895 to 1905, however, branch banking was urged as a much-needed means of banking reform.[1] These proposals were academic, in a sense, being based upon a consideration of branch banking merely from the point of view of its proved advantages in foreign and pre-Civil War American experience. While the suggested plans varied in detail, they had common purposes of bringing about a better distribution of loanable funds, a lowering of the interest rates in country communities, and a provision of safe and adequate banking facilities in the small country communities. There were many country towns too small to support national banks of $50,000 capital which were the smallest permitted by the national banking law. The agitation for banking reform had, as its tangible result, the act of Congress passed in 1900 lowering the capital requirement for national banks in small towns to $25,000.

The branch-banking agitation appears, however, to have had an ultimately more important effect in the education of bankers to the advantages of branch banking, and from the year 1900 onward, branch banking was undertaken to an ever increasing extent by banks operating under state charters. Indeed, in the period after the World War, the growth of such state-bank branch banking became so rapid that national officials feared that the national banks would be completely eliminated in those states where branch banking was permitted.

[1] *Sound Currency*, vols. I–IX, *passim*.

Four sessions of Congress considered bills designed to relieve the national banks in this emergency before the House and the Senate were finally able to agree on the remedy, late in February, 1927.[1] In the meantime, the Comptroller of the Currency had allowed the national banks to establish additional offices, the legality of which is doubtful, and the Federal Reserve Board had applied temporary measures to check the branch-banking activities of state-bank members of the Federal Reserve System. These administrative attempts at relief affected old vested interests and created new ones, thus making the legislative relief still more imperatively necessary.

[1] The McFadden National Bank Act, passed Feb. 25, 1927 (see appendix).

PART I

PRELIMINARY SURVEY OF BRANCH BANKING DEVELOPMENT IN THE UNITED STATES

BRANCH BANKING IN THE UNITED STATES

CHAPTER I

BRANCH BANKING BEFORE THE CIVIL WAR

First and Second Banks of the United States.—The history of the first Bank of the United States, 1791 to 1811, and of the second Bank of the United States, 1816 to 1836, is well known, as is also the story of the opposition to these institutions and their branches. This opposition was fostered by the state institutions, though the selfish interests of the state banks, in their desire for freer activity and for the federal government deposits, would hardly suffice to explain the overthrow of these useful national institutions, had it not been backed by the widespread fear of monopoly and the constitutional objection, which was especially strong in those days of the prevalence of the states' rights doctrine.

According to the law incorporating the second Bank of the United States, the bank was permitted, and under certain conditions might be required, to establish a branch in any state in the Union.[1] The law provided, in part, for the manner in which these branches were to be controlled. All of the directors of a branch were to be residents of the state, territory, or district where the branch was located and were to be appointed by the central board of directors. The local directors were to elect the president of the branch from their own number.[2] The central board, however, appointed the cashiers of the branches.[3]

[1] Catterall, Ralph C. H., "The Second Bank of the United States," Appendix I, p. 485, an act to incorporate the subscribers to the Bank of the United States, Sec. 14.

[2] *Ibid.*

[3] *Ibid.*, p. 377.

With the poor transportation and communication facilities of the time, and with these hampering provisions of law in regard to the personnel of the local directorates, it was not easy for the central board to establish effective control of the branches. The branch directorates were more interested in the welfare of their relatives and neighbors than in that of the bank, in which their direct interest must, at the best, be slight.[1] This lack of control of the branches threatened disaster to the bank until President Biddle found means of controlling the election of the branch presidents through the control of the appointment of the local directors.[2] Even then, it proved impossible adequately to restrict the lending of the Western branches, which succeeded in getting a disproportionate share of the resources of the system.[3]

Although the difficulties of coordination were very real and were never entirely overcome, the second bank with its eighteen branches proved highly successful from a financial point of view, as the first bank with its eight branches had done. During the period of their existence, they greatly reduced exchange charges, transferred money for the government from one part of the country to another, eliminated grave currency disorders which had sprung from the unsound banking practices of many of the state banks, and made profits for the stockholders.[4]

Early State Banks.—While both of the Banks of the United States were successful, the same cannot be said of all of the state experiments conducted along similar lines. During this period before the Civil War, many of the Southern and Western states launched programs of state banking. In some cases, these early state banks seem to have been thinly veiled attempts to evade the federal constitutional prohibition of state issues of bills of credit, and, in most cases, the desire for more paper money and easier credit furnished at least a background for the experiments.

Undoubtedly, the formation of these various state banks was influenced by the example which had been set by the federal government. The characteristic form of organization was

[1] *Ibid.*, pp. 402–403.

[2] *Ibid.*, p. 384.

[3] HUNTINGTON, CHARLES CLIFFORD, "A History of Banking and Currency in Ohio before the Civil War," p. 60.

[4] CATTERALL, *op. cit.*, p. 401.

a branch-banking system. A mere enumeration of some of these banks, with the dates of incorporation and the number of branches, suggests the scope of this early development of branch banking.

One Eastern state, Vermont, established a state bank with branches in 1806. Two branches were operated the first year and two were added the following year, but the experiment proved unsuccessful and the bank was liquidated in 1812.[1] Kentucky had two major experiments in state banking; the first Bank of Kentucky, with thirteen branches, lasted from 1806 to 1822; the second Bank of Kentucky, with six branches, was incorporated in 1834. An act of the Delaware State Legislature incorporated the Farmers' Bank of Delaware on Feb. 3, 1807. The state owned part of the stock of the bank. This bank was successful and, with its three branches, survived the Civil War to continue to the present time. North Carolina chartered the State Bank in 1810; this was followed by the Bank of the State of North Carolina in 1833, which ultimately had eight branches and a number of agencies. The latter was succeeded by the Bank of North Carolina in which the state had no financial interest. South Carolina chartered the Bank of the State of South Carolina in 1812. This bank had two branches and enjoyed a successful career, even passing through the trials of the Civil War, only to be closed by an act of the negro legislature in 1868. The State Bank of Indiana was organized in 1834 and ultimately established thirteen branches. This was succeeded by the Bank of the State of Indiana in 1857 in which the state had no investment. This passed successfully through the Civil War period and disappeared only as the branches were converted into national banks. The Bank of Louisiana, with five branches, was chartered in 1824. The Bank of the State of Alabama, with four branches, was chartered in 1823. The charters of the four branches were withdrawn in 1842 and 1843, and the charter of the parent bank expired in 1845. Tennessee sponsored three projects: the Bank of Tennessee, ten branches, 1838; the Planters' Bank, six branches, 1833; and the Union Bank, five branches, 1832. Arkansas, Missouri, and Ohio also had

[1] Root, L. Carroll, "States as Bankers," *Sound Currency*, vol. II, No. 10, Apr. 15, 1895, pp. 221–252.

branch-banking systems. The State Bank of Ohio, however, was not financed by the state and, while reference is made to the thirty-six branches of the state bank, there was no central bank, and the so-called "branches" were practically independent banks. They were subject to a certain measure of supervision by the central board of control in the same way that national banks are now subject to the supervision of the Comptroller of the Currency.[1]

The State Bank of Indiana and the State Bank of Ohio were very similar, though not identical, in plan. Both banks were made up of a system of so-called branches which were supervised by a central board. In both cases, the branches operated separately as far as profits were concerned. The branches of the Indiana bank, however, were mutually responsible for all of the liabilities of the bank, while the mutual responsibility of the branches of the Ohio bank was restricted to that for note issues for the protection of which a central safety fund of 10 per cent was built up.[2]

In these pre-Civil War branch-banking systems, the degree of state control and ownership varied from state to state and from time to time in the same state. The term "branch" as used in the various states had very different connotations. In some states, as Indiana, Iowa, and Ohio, the branches were practically independent banks, while in others, such as South Carolina, the branches were very restricted and were hardly more independent than mere agencies of the bank.[3] These were the extremes.

> The larger number of these institutions occupied a middle ground, the branches being left to issue their own notes and discount for their own customers, but constantly directed from the parent bank as to general policy.[4]

End of Early Period.—The coming of the Civil War and the passage of the National Bank Act in 1863 mark the end of this early period of state-bank branch banking in the United States.

[1] White, Horace, "National and State Banks," *Sound Currency*, vol. IV, No. 10, pp. 3, 5.

[2] Huntington, "A History of Banking and Currency in Ohio before the Civil War," pp. 253–254.

[3] Root, "States as Bankers," p. 251.

[4] *Ibid.*

The following banks with branches appear to have been in existence in 1863:[1]

	Number of Branches
Bank of the State of Indiana	13
State Bank of Iowa	14
State Bank of Ohio	36
Bank of Kentucky	8
(Six other banks with branches in Kentucky)	
Merchants' Bank of St. Louis	1
Mechanics' and Merchants' Bank, West Virginia	2
Farmers' Bank of Delaware	3
Bank of South Carolina	2
North Carolina, sixteen banks	26 (in 1860)
Union Bank of Tennessee	7
Bank of Tennessee	10
Planters' Bank, Tennessee	6
Total, 33 banks	128

The first three banks listed above were, in reality, systems of semi-independent banks, but the remaining thirty banks in the list were head offices of real branch-banking systems and operated more than sixty-five branches in all. Real branch banking was very definitely concentrated in the Southern states.

EARLY BRANCH-BANKING LEGISLATION

While the development of branch banking in the Southern and Western states described in the preceding pages was taking place, the Northern states had developed three different systems of banking, all of which encountered a considerable degree of success: the Free Bank System and the Safety Fund System of New York and the Suffolk Banking System of New England. It would be aside from the point to give an extended discussion of these systems. Only one of these, the Free Bank System, has any fundamental bearing on the subject of branch banking, although the others have indirect bearing, inasmuch as they furnished a satisfactory banking system for the needs of the time, and little demand for a change might be expected.

[1] *Annual Report* of the Secretary of the Treasury on the condition of the banks of the United States at the commencement of the year 1863, *passim; cf.*, also, Dewey, Davis Rich, "State Banking before the Civil War," p. 138, and Knox, John Jay, "A History of Banking in the United States," *passim*, and especially, pp. 639–640.

Major Evils.—Nevertheless, during this early period, two major evils in banking were suffered by the public. The first of these was "wild-cat" banking, and the second, the bribery and corruption of the legislature which resulted from the practice of giving special charters to banks. The common practice of the time was to pass a special act of incorporation for all kinds of corporations, turnpike companies, canal companies, railroad companies, and, finally, banks. It was not to be expected that the idea of a general act under which banks might easily be formed would immediately suggest itself to the legislators as a possibility. Historic precedent demanded the special act.

Reforms.—Two methods of avoiding the evils of the special-charter system were discovered; the first of these was "free banking." On Apr. 18, 1838, there was enacted in the state of New York a law providing for so-called free banking.[1] Under the provisions of this law, any person, or association of persons, was permitted to deposit, with the state comptroller, certain securities and to receive circulating notes which might be signed and issued as money. This was a form of general incorporation act and constituted a remedy for the political corruption which resulted from the use of special charters.

The second reform was directed against the abuses of wild-cat banking. So-called "banks" were being formed merely for the purpose of issuing notes and with purely nominal places of business. The notes were put into circulation at a distance from the "home" of the bank in order to make redemption slow, if not impossible. In 1844, the New York legislature passed an act designed to correct this abuse of the note-issuing power.[2] The act provided that nobody should conduct business as a banker except at the place of his actual residence. This was a prohibition of branch banking, but it was clearly directed against a misuse of agents and not against branch banking proper.

The bank commissioners of Connecticut and Rhode Island had occasion to complain of similar abuses in 1836 and 1837.[3] The former contended that these agencies were not permitted by law and should therefore be prohibited. In Rhode Island, the

[1] Laws of New York, 1838, Ch. 260.

[2] White, "Money and Banking," 5th ed., pp. 313–314.

[3] Dewey, "State Banking before the Civil War," p. 141.

legislature passed a law which prohibited offices or agencies for discount at any other place than the bank itself, except by express permission of the bank commissioner. Even as late as 1852, the Massachusetts bank commissioners had occasion to condemn the practice of banks chartered in nearby towns in their sending of cashiers to State Street, Boston, for the purpose of receiving deposits, paying checks, and discounting notes.[1] The bank commissioners issued an order prohibiting this practice.[2] It does not appear that specific legislation against branch banking was adopted in any states except New York and Rhode Island, though the bank commissioners of some states interpreted the existing laws as failing to permit the establishment of branches.[3]

In some cases, there were provisions in the state constitutions with regard to branch banking. The constitution of the state of Indiana, adopted in 1816, prohibited the legislature from incorporating any bank unless it should be a state bank with branches.[4] This was a second way of avoiding the special-charter evils, since this provision prevented the legislature from granting new charters after the first had been given. The Michigan constitution contained a provision which gave the legislature power to incorporate a state bank with branches.[5] It is apparent that these constitutional provisions touched on branch banking only in an indirect sort of fashion.

[1] *Report* of the Bank Commissioners of Massachusetts, 1852, p. 8.

[2] Dewey, *op. cit.*, p. 142.

[3] *Ibid.*, pp. 136–143.

[4] *Ibid.*, p. 139.

[5] Michigan Constitution, Art. XV, Sec. 1, *cf. infra*, p. 114.

CHAPTER II

BRANCH BANKING IN THE NATIONAL BANKING SYSTEM, 1863–1921

The Civil War came upon a country equipped with an entirely inadequate banking machinery. After its experience with the second Bank of the United States, the federal government had withdrawn completely from the field of banking, even to the extent of setting up the independent treasury to care for government funds. In the intervening years, the number of state banks had increased until there were 1,466 of them in 1863.[1] These banks were being operated under diverse state laws. There were thousands of different kinds of bank notes in circulation, and, besides the good notes, there were many counterfeits.

National Bank Act, 1863.—Secretary Chase was aware of the evils of a non-uniform currency, and, in his first report (1861), he proposed that a national measure be passed which would bring uniformity in the currency.[2] Bills were actually prepared by several members of Congress in 1861 and 1862, but no action was taken on them.[3] It was not until early in 1863 that the act was passed which brought uniformity to the currency of the country. This act was the National Bank Act which became law with the approval of the President on Feb. 25, 1863.[4]

Branch Banking Not Considered.—Branch banking was not a subject which occupied much of the attention of either the proponents or the antagonists of the law. It is, therefore, somewhat difficult to state exactly why the law stands as it does on the question of branch banking.

[1] *Annual Report* of the Secretary of the Treasury on the condition of the banks in the United States at the commencement of the year 1863, p. 210.

[2] Davis, Andrew McFarland, "The Origin of the National Banking System" (Senate *Document*, No. 582, 61st Congress, 2nd Session), p. 32.

[3] *Ibid.*, pp. 55, 61.

[4] 12 Stat. L., 665.

There can, however, be little doubt that the prevalent opposition to monopoly precluded anything in the nature of a single national bank with branches. That issue had apparently been settled in the public mind.[1] Moreover, in a time of war it would have been extremely inadvisable to antagonize the numerous state banks by any such plan. On the other hand, the possibility of allowing the numerous national banks, under the proposed plan, to establish branches was not seriously considered, if considered at all.

Branch banking was not the issue involved. Secretary Chase was endeavoring to bring about uniformity in the currency,[2] with incidental advantages to the government in a market for government bonds and safe depositories for government funds. For this primary purpose, the free-banking system, as finally developed in New York, furnished a most obvious model.[3] This system had been adopted by fourteen other states before 1860[4] and was therefore very familiar to the members of Congress. On the other hand, real branch banking was practically unknown in the Northern states.[5] Nevertheless, it cannot be said that the law was a mere copy of the New York law,[6] for then it would have had a specific prohibition of branches.

Branch-banking Provisions.—The original National Bank Act of 1863 did not refer specifically to branch banking. Two clauses of the act, however, refer by implication to branch banking. A clause in the section which enumerated the specifications of the organization certificate of a national banking association, stated that the certificate should specify:

> The place where its operations of discount and deposit are to be carried on, designating the State, Territory, or District, and also the particular county, and city, town, or village.[7]

[1] Scudder, M. L., Jr., "National Banking: A Discussion of the Merits of the Present System, 1879," pp. 17, 24, 25.

[2] Davis, *op. cit.*, p. 109.

[3] *Ibid.*, p. 7.

[4] *Ibid.*, p. 12.

[5] *Supra*, p. 7.

[6] Prager, Max, "Die Reichsbankidee in der Vereinigten Staaten von Amerika," p. 8. (Contrast: "gedankenlos abgeschrieben," etc.)

[7] 12 Stat. L., 666; 13 Stat. L., 100, Sec. 6.

In the section which gave the powers of national banking associations, this clause appeared:

And its usual business shall be transacted in banking offices located at the places specified respectively in its certificate of organization.[1]

The use of the plural, "offices," in the second clause quoted, was an authorization of branch banking, though the plural, "places," appears to contradict the singular used in the first clause.

Revision of 1864.—The original act was defective in many ways and was thoroughly revised by the Act of June 3, 1864, in which the inconsistency of the two clauses dealing with the place of doing business was removed by altering the second clause to read as follows:

And its usual business shall be transacted at an office or banking house located in the place specified in its organization certificate.[2]

This change which removed the authority for national-bank branch banking seems to have been made without any debate or very serious consideration.[3]

Ten Per Cent Tax.—Both the Act of 1863 and that of 1864 provided for the conversion of state banks into national associations, but neither made any provision for the retention of existing branches.[4] An act of Mar. 3, 1865, which was an amendment to the Revenue Act of June 30, 1864, imposed a tax of 10 per cent upon the note issues of state banks.[5] With the apparent purpose of removing objections to the severity of this law, which was intended to compel the state banks to come into the national system, permission was given to state banks converting into national banks to retain their branches:[6]

[1] 12 Stat. L., 668, Sec. 11.

[2] 13 Stat. L., 100, Sec. 8, corresponding to Sec. 11 of the earlier act.

[3] Knox, "A History of Banking in the United States," Chap. XV, Currency Act of June 3, 1864. In this chapter, which gives a detailed account of the discussion of the act in Congress, there is not a single reference to this change.

[4] 12 Stat. L., 68, Sec. 61; 13 Stat. L., 113, Sec. 44.

[5] 13 Stat. L., 469.

[6] *Ibid.*

Provided, That it shall be lawful for any bank or banking association organized under state laws, and having branches, the capital being joint and assigned to and used by the mother bank and branches in definite proportions, to become a national banking association in conformity with existing laws, and to retain and keep in operation its branches or such one or more of them as it may elect to retain; the amount of the circulation redeemable at the mother bank and each branch to be regulated by the amount of capital assigned to and used by each.

The Consolidation Act of Nov. 7, 1918.—In spite of active agitation for branch-banking legislation in the period from 1895 to 1900, no change was made in the national law relating to branch banking until the passage of the National Bank Consolidation Act of Nov. 7, 1918. This act provided that two or more national banks might consolidate into a single bank under the charter of any one of the banks entering the consolidation and that the consolidated bank should hold and enjoy "all rights of property, franchises, and interests in the same manner and to the same extent as was held and enjoyed" under the relinquished charters.[1]

Under the Act of Mar. 3, 1865, state banks had been permitted to convert into national institutions and still retain their branches. Under the Consolidation Act of 1918, such national banks with branches were permitted to consolidate with other national banks and retain the existing branches. While the national bank resulting from such a consolidation is permitted to operate all of the former branches, the Comptroller of the Currency has interpreted the act as not permitting the operation of either of the former main offices as a branch.[2]

SLOW DEVELOPMENT OF BRANCH BANKING IN THE NATIONAL SYSTEM

Disappearance of Branch Banks in the South.—In spite of the permission granted by the Act of 1865, the branch banks existing at the time of the adoption of the act did not come into

[1] The Consolidation Act of Nov. 7, 1918, Sec. 7.

[2] Collins, Charles Wallace, "The Branch Banking Question," pp. 46–47.

the national system as branch banks. Some of the Southern systems were destroyed by the war and the reign of the carpet-baggers. In other cases, the state authorities chose to dissolve the state institutions rather than to allow their conversion into national banks. In these ways, the branch banks of North Carolina, South Carolina, and Tennessee disappeared.[1] The Bank of Kentucky closed all but one of its branches during the war. After 1865, it gave up the circulation privilege and continued as a state bank.[2] The Farmers' Bank of Delaware also continued as a state institution on the decision of the directors, although the state legislature had authorized conversion into a national bank.[3]

Conversion in the North.—The northern branch banks, those of Indiana, Iowa, and Ohio, came into the national system as independent national banks rather than as branch banks.[4] This was to be expected, since they were essentially independent institutions even before the conversion.[5] The records of the early years of the national banking system do not disclose the admission of any branch banks.

Growth since 1900.—The increase in number of branches of national banks has been confined to the period since 1900. In fact, there were only three or four national banks which had branches even as late as 1909.[6] By 1920, the number had increased to sixteen banks with fifty-eight branches.[7] By the end of the following year, the number of national banks engaged in branch banking was seventeen, and these banks had sixty-six branches. The distribution of the banks and their branches is shown in the following table:[8]

[1] KNOX, "A History of Banking in the United States," pp. 559, 569, 653, 657–658.

[2] *Ibid.*, p. 642.

[3] ROOT, L. CARROLL, "States as Bankers," p. 228.

[4] KNOX, *op. cit.*, pp. 685, 704, 777.

[5] *Supra*, p. 6.

[6] BARNETT, GEORGE E., "State Banks and Trust Companies since the Passage of the National Bank Act," p. 135.

[7] *Report* of the Comptroller of the Currency, 1920, vol. I, pp. 225–227.

[8] *Ibid.*, 1921, pp. 107–109.

NATIONAL BANKS AND THEIR BRANCHES IN THE UNITED STATES, 1921

State and name of bank	Number of branches		
	Home city	Other	All
Converted from State Banks			
California:			
First National Bank of Bakersfield	..	3	3
Bank of California, National Association, San Francisco	..	3	3
Louisiana:			
Calcasieu National Bank of Southwestern Louisiana, Lake Charles	..	8	8
Michigan:			
City National Bank of Battle Creek	1	..	1
National Union Bank of Jackson	1	..	1
New York:			
Chatham & Phenix National Bank of New York	12	..	12
Metropolitan National Bank of New York	7	..	7
Public National Bank of New York	5	..	5
North Carolina:			
American Exchange National Bank of Greensboro	..	1	1
Oregon:			
First National Bank of Milton	..	1	1
Washington:			
Union National Bank of Seattle	..	2	2
All Twelve Banks	26	18	44
Under the Consolidation Act of 1918			
New York:			
National Commercial Bank & Trust Co. of Albany	1	..	1
National City Bank of New York[1]	3	..	3
Irving National Bank, New York	8	..	8
Mechanics & Metals National Bank, New York	9	..	9
Virginia:			
First National Bank of Abingdon	1	..	1
All Five Banks	22	0	22
Total of Seventeen Banks	48	18	66

[1] The National City Bank of New York had a number of foreign branches, also.

The change that had taken place since 1920 was largely confined to New York City which had forty-four of the forty-nine local branches of national banks in the United States in 1921. The tendency for national banks in New York City to take advantage of the permissive features of the national law was manifested both with regard to the new Consolidation Act and the older provision embodied in the Act of 1865, since twenty-four of the branches were held by converted institutions while twenty had been acquired through consolidations.[1]

On the whole, however, the national bank development of branch banking was slight, even as late as 1921. In the meantime, the state banks had not been idle, and for an understanding of the developments of the last few years, that is, from 1921 to 1926, it is necessary to consider first, in detail, some of the features of state bank history.

[1] *Report* of the Comptroller of the Currency, 1921, pp. 107–109.

CHAPTER III

BRANCH BANKING IN THE STATE BANKING SYSTEMS, 1863–1926

The passage of the act taxing state bank-note issues at 10 per cent marks the end of the early period of state banking, for this act forced most of the state banks to come into the national system or discontinue business. State banks declined in number from 1,562, in 1860, to 247, in the year 1868.[1] In many of the states the state systems were completely absorbed into the national system. Among these states were Maine, New Hampshire, Massachusetts, and New Jersey.[2] Others had very few state institutions left; for example, Maryland had two state banks, Connecticut four, Vermont eight, Pennsylvania six, and Michigan one. In some of the Southern states the state banks had been completely eliminated by the Civil War and the 10 per cent tax.[3] Wherever note issue had been the main reliance of the banks, the progress of nationalization was most rapid. The few California banks were not affected by the tax, since they did not issue notes; and the New York banks had developed deposit banking to a considerable extent and were therefore less affected by the tax than most of the banks in other less industrially advanced sections of the country.[4]

State Banking Laws.—State banks began to increase in number after 1870, but for many years the various state laws relating to banks remained unchanged and were therefore unsuited to the new type of non-note-issuing banks which were being formed.[5]

[1] Barnett, "State Banks and Trust Companies since the Passage of the National Bank Act," p. 11.

[2] Knox, "A History of Banking in the United States," pp. 334, 340, 341, 369, 436.

[3] *Ibid.*, pp. 461, 516, 387, 738; Virginia, p. 535, North Carolina, p. 559, South Carolina, p. 569.

[4] *Ibid.*, pp. 422, 845.

[5] Barnett, *op. cit.*, pp. 11, 12.

In a digest of state law as late as 1892, it was said:

> It seems unnecessary to incorporate the state banking laws in this edition. Nearly all of the States, except the newer States and Territories, have special chapters in their corporation acts concerning banks and moneyed institutions, but these chapters are usually of old date, and have practically been superseded for so long a time by the national banking laws that they have become obsolete in use and form.[1]

Gradually, however, state laws were being evolved to meet the new conditions. These laws, more or less experimental in character at first, permitted the establishment of trust companies and of stock savings banks,[2] two fields of banking in which the national banks were not then active. By a process of evolution of both law and practice, these new institutions gradually acquired the more general banking powers which are now associated with the modern trust company and the so-called "savings bank," which exists in many of the Western states, particularly. Thus, there arose a competition between the old established national banks and these new state institutions in the field of commercial banking.

In view of this irregular development of state banking, it is not surprising that the laws affecting branch banking were of an extremely miscellaneous character and that in many cases branch banking was either permitted or forbidden by state authorities, merely because the law was silent on the subject. A general survey of the subject must necessarily depend upon previous compilations of the branch-banking laws at various times. Three such compilations are available, one as of the year 1898, another of 1909, and the last of 1925.[3] Only the last of these is complete in dealing with all the states of the Union.

[1] STIMSON, cited by Barnett, *op. cit.*, p. 11.

[2] *Cf.* pertinent comments in *Annual Report* of the Bank Commissioner of Massachusetts, 1918, p. vii, also *Annual Report* of the Commissioner of Banking of Pennsylvania, 1913, Part I, p. 7.

[3] BRECKINRIDGE, R. M., *Bankers Magazine*, January, 1899.
WELLDON, SAMUEL A., "Digest of State Banking Statutes." (1909).
Federal Reserve Bull., March, 1925, pp. 182–187.

STATES PROHIBITING BRANCH BANKING

Perhaps the best method of presenting the situation is to simplify by a process of elimination, starting with the states where branch banking does not exist and proceeding to those where it exists in the fullest degree. This will mean that the present situation is chosen as the basis of division into groups. In nine states, branch banking is not now practiced as a result of prohibitive rulings of administrative authorities, although no statutory prohibition of branches exists. These states are Iowa, Kansas, Montana, New Hampshire, North Dakota, South Dakota, Oklahoma, Vermont, and West Virginia. This represents the extreme of lack of interest in branch banking, since not even enough regard has been given to the subject to bring about prohibitory legislation. None of these states has had branch banking since the Civil War.

In a second group of states, branch banking is now expressly prohibited and does not exist in any form. There are nine states in this group also: Colorado, Connecticut, Idaho, Illinois, Missouri, Nevada, New Mexico, Texas, and Utah. In several of these states, in 1909, the laws were silent on the subject of branch banking. In Nevada, alone, of this group, was there a law permitting branch banking in 1898, and this law had been repealed before 1909. A history of the passage of these acts prohibiting branch banking in the various states under consideration is not available. The Colorado prohibition appears to have been copied directly or indirectly from the General Statutes of Connecticut.[1] In Illinois, the prohibition of branch banking was made specific by an amendment to the Bank Act which was submitted to a popular referendum in 1924 and carried by a two-to-one vote, 1,088,153 to 517,827.[2] The fact that the bankers of Illinois are among the most active opponents of branch banking makes this vote less surprising, since the public can hardly be well enough informed on such a technical subject to have an independent opinion.

In a third group of states, branch banking is prohibited in all forms, except that branches which were in existence at the time

[1] General Laws of Colorado, 1876, Chap. XIX, Sec. 68; General Statutes of Connecticut, 1875, Sec. 283.

[2] *The Independent Banker*, February, 1925, p. 2.

of the passage of the various restrictive acts are permitted to continue in operation. This group includes Alabama, Arkansas, Florida, Indiana, Minnesota, Nebraska, Oregon, Washington, and Wisconsin. Three of these states, Florida, Oregon, and Washington, definitely permitted branch banking in 1909 but have since passed laws prohibiting it. New Jersey was also included in this group of states prohibiting branch banking, but when the McFadden National Bank Bill was enacted by Congress in February, 1927, this prohibition was automatically lifted, for a state law had been passed in 1925[1] permitting state banks and trust companies to establish branches on condition that the national banks in New Jersey "shall at the time be permitted by act of Congress to establish branches."[2] Before this time, New Jersey had had a law allowing the establishment of branches, but this earlier law had been repealed in 1915 after only two years of operation. In the following ten years there had been no statutory provision in the matter, but the administrative policy had been to prohibit the establishment of new branches and to allow the already established branches to continue.[3] In Nebraska and Minnesota, the state prohibitions of branches were directed against the branches of state institutions only. In Minnesota the prohibition is statutory, while in Nebraska it is administrative.[4] In both states the only branches in operation are branches of national banks. The two branches in Nebraska exist by permission of the Comptroller of the Currency.[5] The eleven branches in Minnesota were established without official sanction of any sort.[6] These Minnesota national bank branches have been continually referred to in the controversy over the national branch-banking legislation. The opponents of branch banking contended that these branches were illegally established and should not receive the sanction of law.[7] To meet this objection,

[1] Bills were pending in the 1927 State Legislature to make this permission effective at once. *Cf. The Chronicle*, Feb. 12, 1927, p. 877.

[2] *Federal Reserve Bull.*, June, 1926, p. 401.

[3] *Ibid.*, March, 1925, p. 185.

[4] *Ibid.*, December, 1924, p. 931; March, 1925, p. 185.

[5] *Report* of the Comptroller of the Currency, 1924, p. 17.

[6] *Congressional Record*, May 12, 1926, pp. 9196–9197.

[7] *Ibid.*; *cf.* also, *The Chronicle*, May 1, 1926, pp. 2442–2443.

the act, as finally passed, contains the word "lawful" in the following subsection:

(*a*) A national banking association may maintain and operate such branch or branches as it may have in lawful operation at the date of the approval of this Act . . . [1]

The development of branch banking in the ten states discussed in the preceding paragraph has been small. In December, 1924, there were only eighty-two branches of banks in all of them, and of these branches twenty-one were in New Jersey and nineteen in Alabama, nearly half of the total. Since new growth was not permitted by law, as branches were closed the total number of branches in these states declined. By December, 1926, Florida's one branch bank had been closed, only six branches were left in Minnesota, and the total number of branches in all of these states had declined from eighty-two to seventy-five.

BRANCH BANKS IN STATES PROHIBITING NEW BRANCHES,[1] DEC. 31, 1926

State	National			State			Both	
	Banks	Branches		Banks	Branches		Banks	Branches
		Local	Other		Local	Other		All
Alabama	..	..	..	5	..	19	5	19
Arkansas	..	..	..	2	..	3	2	3
Indiana	..	..	..	4	7	1	4	8
Minnesota	2	6	..	..	..	..	2	6
Nebraska	2	2	..	..	..	..	2	2
New Jersey	2	1	2	11	9	8	13	20
Oregon	1	..	1	..	..	..	1	1
Washington	2	3	..	3	1	3	5	7
Wisconsin	1	2	..	6	5	2	7	9
Totals	10	14	3	31	22	36	41	75

[1] *Federal Reserve Bull.*, May, 1927, pp. 387–388, Table 9.

STATES PERMITTING BRANCH BANKS

In the states where branch banking was permitted before the passage of the McFadden Act in February, 1927, the conditions

[1] See text of act, appendix, Sec. 7.

under which it might be undertaken varied from state to state. There were twenty of these states besides the District of Columbia. In none of them, except Mississippi and Pennsylvania, where local offices or agencies were then permitted, had a previous prohibition of branch banking been removed since 1909. In one state, Tennessee, a new restriction had been imposed by an act passed in 1925, limiting the establishment of new branches to the same county as that in which the head office of the bank may be located.[1]

In four states, Kentucky, Michigan, Mississippi, and Pennsylvania, the branch offices are limited in their functions and are referred to as "agencies." In six states, branch banking is restricted in locality; New York, Massachusetts, and Ohio, with slight exceptions, restrict branches to city limits; Louisiana and Tennessee restrict the branches to parish and county limits, respectively, while Maine permits the establishment of branches in counties adjoining that in which the parent bank is located. In the remaining ten states and the District of Columbia, statewide branch banking is permitted. In this group are the following states: Arizona, California, Delaware, Georgia, Maryland, North Carolina, South Carolina, Rhode Island, Virginia, and Wyoming. In Wyoming, alone, of these states which permit branch banking, has there been no development.

The entire development of present-day branch banking in the United States has been a very recent matter. Only four or five branch banks appear to have survived the Civil War period. They are the Farmers' Bank of Delaware, with its three branches, and one or two Kentucky banks, with branches.[2] By 1890 there were hardly a dozen branches in the whole United States.[3] By 1900 there were at least 60; by 1905, 166; by 1910, 329; by 1915, 565; and by 1920, 1,052.[4] The number had increased to 2,243 by June, 1924.[5]

[1] An act, passed Apr. 6, 1925, to amend Chap. 20 of the Public Acts of 1913 (Tennessee). *Federal Reserve Bull.*, July, 1925, p. 486.

[2] *Supra*, p. 14.

[3] *Federal Reserve Bull.*, December, 1924, p. 935, Table 9; *cf.*, also, Attfield, J. B., "The Branch Bank System," *Sound Currency*, Aug. 1, 1897, vol. IV, No. 15, p. 3, Ed. footnote.

[4] *Federal Reserve Bull.*, December, 1924, p. 935, Table 9.

[5] Ibid., pp. 938–939.

From June, 1924, to December, 1926,[1] there was a very rapid growth of branch banking in three states: New York, 145 branches, California, 130 branches, and Michigan, 65 branches, making a total of 340 new branches. A slower growth occurred in Massachusetts, 34 branches, Pennsylvania, 29, Maryland, 26, Ohio, 24, Virginia, 14, and Louisiana, 11. In the remaining states the growth was still less, and in a few of them there was a net loss in number of branches. The total net increase in number of branches in the whole United States during this period was 484. On Dec. 31, 1926, there were 2,777 branches in operation and 789 banks engaged in branch banking in the United States. These 789 banks constituted only 2.9 per cent of the 27,377 banks in the country, but the importance of branch banking is not to be minimized on that account, since the branch-banking development has been very definitely localized, and in those states where the growth has been most rapid, the effects are out of all proportion to the number of banks engaged. In California, for example, while only 88 of the 626 banks in the state were engaged in branch banking, on Dec. 31, 1926, they operated 668 branches, which, with the head offices, constituted more than 54 per cent of the banking offices in the state.

The increase in branch banking in the various states, from June, 1924, to Dec. 31, 1925, and from the latter date to Dec. 31, 1926, is shown in the following tables:

[1] *Cf.* tables on following pages.

Growth of Branch Banking in the United States from June, 1924, to December, 1926[1]

States arranged in order according to number of parent banks	Banks operating branches					Number of branches				
	December, 1926	December, 1925	June, 1924	Increase[2] 1925 to 1926	Increase[2] 1924 to 1925	December, 1926	December, 1925	June, 1924	Increase[2] 1925 to 1926	Increase[2] 1924 to 1925
Total	789	786	714	3	72	2,777	2,645	2,293	132	352
New York	105	98	77	7	21	507	459	362	48	97
California	88	100	99	−12	1	668	640	538	28	102
Pennsylvania	83	85	67	−2	18	127	122	98	5	24
Massachusetts	78	72	61	6	11	132	117	98	15	19
Michigan	68	64	63	4	1	397	384	332	13	52
Ohio	52	52	51	...	1	227	213	203	14	10
Louisiana	40	35	34	5	1	104	95	93	9	2
North Carolina	40	39	40	1	−1	74	69	66	5	3
Virginia	37	33	31	4	2	59	50	45	9	5
Maryland	36	36	27	...	9	114	109	88	5	21
Maine	24	24	23	...	1	53	50	47	3	3
Georgia	22	23	21	−1	2	38	56	53	−18	3
Tennessee	22	24	21	−2	3	56	58	53	−2	5
New Jersey	13	14	14	−1	...	20	21	21	−1	
Mississippi	11	11	11	...	...	25	25	25		
District of Columbia	10	10	11	...	−1	20	20	19	...	1
Rhode Island	9	10	9	−1	1	27	27	21	...	6
Arizona	7	7	6	...	1	22	21	20	1	1
South Carolina	7	8	9	−1	−1	25	19	20	6	−1
Wisconsin	7	7	7	...	...	9	9	9		
Alabama	5	5	5	...	...	19	19	19		
Delaware	5	5	5	...	...	15	15	18	...	−3
Washington	5	6	5	−1	1	7	7	7		
Indiana	4	4	4	...	...	8	8	8		
Kentucky	4	4	4	..	...	12	12	12		
Arkansas	2	2	2	...	...	3	3	3		
Minnesota	2	3	3	−1	...	6	10	11	−4	−1
Nebraska	2	2	2	...	...	2	2	2		
Oregon	1	1	1	...	...	1	1	1		
Florida	...	1	1	−1	...	...	1	1	−1	
New Hampshire	...	1	...	−1	1	...	3	...	−3	3

[1] *Federal Reserve Bull.*, May, 1927, p. 386, Table 8.
[2] Exact dates: Dec. 31, 1925, to Dec. 31, 1926; June 30, 1924, to Dec. 31, 1925.

GEOGRAPHICAL DISTRIBUTION OF BRANCH BANKS IN THE UNITED STATES, DEC. 31, 1926[1]

State	National banks			State banks			All	
	Banks	Branches		Banks	Branches		Banks	Branches
		In home city	Outside home city		In home city	Outside home city		
Total	141	377	27	648	1,551	822	789	2,777
Alabama	..	..	..	5	.....	19	5	19
Arizona	..	..	..	7	.....	22	7	22
Arkansas	..	..	..	2	.....	3	2	3
California	16	75	10	72	256	327	88	668
Delaware	..	..	..	5	1	14	5	15
Georgia	3	6	1	19	6	25	22	38
Indiana	..	..	..	4	7	1	4	8
Louisiana	1	..	8	39	52	44	40	104
Maine	..	..	..	24	4	49	24	53
Maryland	4	6	..	32	52	56	36	114
Massachusetts	16	49	..	62	67	16	78	132
Minnesota	2	6	..	..	.....	..	2	6
New Jersey	2	1	2	11	9	8	13	20
New York	26		..	79	378	1	105	507
North Carolina	3	128	..	37	4	66	40	74
		4						
Ohio	5	5	..	47	189	33	52	227
Oregon	1	..	1	..	.....	..	1	1
Rhode Island	..	..	..	9	10	17	9	27
South Carolina	2	6	2	5	1	16	7	25
Tennessee	6	9	..	16	15	32	22	56
Virginia	8	10	2	29	18	29	37	59
Washington	2	3	..	3	1	3	5	7
Wisconsin	1	2	..	6	5	2	7	9
District of Columbia	5	9	..	5	11	..	10	20
In States not permitting full-power branches								
Kentucky	3	7	..	1	5	..	4	12
Michigan	11	20	..	57	370	7	68	397
Mississippi	1	..	1	10	1	23	11	25
Nebraska	2	2	..	..	.....	..	2	2
Pennsylvania	21	29	..	62	89	9	83	127

[1] *Federal Reserve Bull.,* May, 1927, pp. 387–388, Table 9, rearranged.

Sufficient material is not available for an adequate treatment of the development of branch banking in all of the states where there are branches. In many cases, particularly in the South, the states have not compiled and published the data relating to state banks. For this reason, in part, and in part to avoid needless repetition, a few states, where the development has been most significant, have been selected for further detailed treatment. Among these, California comes first both because of the greater extent of the development in that state, and because the development there has had the greatest effect on the national situation. The method of treatment has been to consider, first, the legislation or laws under which branch banking is permitted; then, the reasons for the passage of this legislation; after that, the development of branch banking under this legislation, the problems created by this development; and, finally, the attempts which are being made at their solution.

PART II

BRANCH BANKING IN CALIFORNIA

CHAPTER IV

THE EARLY PERIOD OF BRANCH BANKING IN CALIFORNIA, 1884–1908

Rulings of the Attorney General.—Before the passage of the Bank Act, in 1909, branch banking in California was carried on without specific statutory authority under the rulings of the Attorney General of the state. The first of these rulings dealing with branch banking is contained in a letter written on Oct. 7, 1903, to the board of bank commissioners in reply to certain questions raised by them.[1] A few banks had opened agencies at different points in the county in which they were incorporated. Instead of using the name of the parent bank for the agency, they used the name of the town in which the agency was located. The bank commissioners wished to know whether it was legal for the banks to open and conduct these agencies in this fashion. The Attorney General replied that he was of the opinion that certain statutes gave "express authority to banks in this State to open an agency in the same county in which the said bank is incorporated." He supported his ruling by the following quotations from the Civil Code:

> Sec. 354: Every corporation, as such, has power: . . . 5. To appoint such . . . agents as the business of the corporation may require; . . . 8. To enter into any . . . contracts essential to the transaction of its ordinary affairs, or for the purposes of the Corporation.

Since all corporations in California were required to be formed under general statutes and the general statutes became a part of the charter, he concluded that the above provisions relating to corporations in general applied also to banking corporations. He ruled, further, that the agency should be conducted under the

[1] Banking Laws of California (1907), compiled by Commissioner Nehemiah Blackstock, p. 174.

name of the parent bank rather than the name of the community in which the agency was located.[1]

The second ruling relating to branch banking or agencies was made in 1905. By this opinion the implied limitation of agencies to the same county in which the parent bank was located was disavowed. He wrote:

> It is my opinion that the law cited by me in my former communication applies to the establishment, by a banking corporation organized under the laws of this State, of agencies either within or without the county in which it may have been incorporated, or in which it may have its principal place of business.[2]

No reference was made in the correspondence to a limitation in the functions of these agencies. In fact, the work they did was that of a regular branch.[3] Presumably, they were called "agencies" because that term was used in the law, or rather the term "agent."

Early Growth of Branch Banking.—While two Canadian banks had branches in San Francisco, even at the time of the Civil War,[4] the present branch-banking development in California began much later. In January, 1884, the banking house of Rideout and Smith, a partnership, established a branch in the town of Gridley. Mr. Rideout had already established banks in Oroville, Willows, Chico, and Sacramento. These banks were all connected by private telephone. The Rideout and Smith Bank was located at Marysville. In 1890, this was incorporated under the name of the Rideout Bank.[5]

The growth was very slow in these early years, and by 1905 there were only five branches of California banks in the state.[6]

[1] Banking Laws of California (1907), p. 174.

[2] *Ibid.*, p. 186.

[3] Letter from Dunning Rideout, vice-president of the Bank of Italy, Rideout Branch: "The Gridley Branch operated as any bank does—, the loans were made after consulting with the head bank when necessary. As far as I know this was the first branch in California."

[4] Wright, Benjamin C., "Banking in California, 1849–1910," p. 48.

[5] Letter of Dunning Rideout, vice-president, Bank of Italy, Rideout Branch, dated, Dec. 4, 1925, Marysville, Calif.

[6] *Annual Reports* of the Board of Bank Commissioners of California, *passim*. It was necessary to compile statistics from the individual reports of the banks.

The Nevada City Citizens Bank (Nevada City, Calif.) had a branch at Grass Valley. The Nevada County Bank (Grass Valley) had a branch at Nevada City. In Etna there was a branch of the Carlock Banking Company (Fort Jones). The Rideout Bank still maintained its agency at Gridley. The United Bank and Trust Company of San Francisco had opened a branch office in that city.

In several cases, these offices were referred to as "branches" rather than agencies. No distinction seems to have been made between the two terms. Four of the offices were branches of country banks and located in small towns. Only one was in a city. Two systems, one of Grass Valley and the other of Nevada City, had entered into competition with each other.

Several new branches were established in 1906. The Bank of Santa Maria started a branch at Guadalupe; the Bank of Cloverdale, a branch at Hopland; and the California Bank (Oakland), a branch in Oakland. The California Safe Deposit and Trust Company in San Francisco established three branches in different parts of the city, and the Anglo-California Bank also established a branch in the city before the middle of that year. Although intracity branch banking seemed to be well under way in San Francisco, there was a great element of weakness in the situation. The three branches of the California Safe Deposit and Trust Company were like the shoots put out by a dying tree —a last vain effort to live. The bank failed in 1907. The receiver's findings, in this case, show the motive for the establishment of the branches and indicate certain dangers associated with chain banking.[1]

The California Safe Deposit and Trust Company was incorporated, April 12, 1882, with a capital of $2,000,000. Its capital when the bank failed, October 30, 1907, had been increased to $2,625,000. It arose from the ashes of the Pioneer Savings and Loan Association, the Duncan Bank so-called, of unfortunate memory, and from its inception, the California Safe Deposit and Trust Company had a very large part of its assets invested in its building, crippling it, in a measure, for the banking business.

[1] *Annual Report* of the Board of Bank Commissioners of California, 1908, p. 21.

After some years of moderate business it embarked in large loans to James and John Treadwell and their coal company in Alameda County, and to these loans to bolster up which immense sums of the bank's assets were employed, the downfall of the bank may be attributed.

After the fire[1] the managers carried out the plan of establishing four branch banks in different parts of the city, the main object being to secure new deposits. Two of these branches were fitted up at great expense of rent and fixtures, with safe deposit vaults. A most expensive department of "Promotion and Publicity" was established on Fillmore Street, and the city and county were covered with advertisements soliciting deposits. The bank suspended about fifteen months after these branches were started.

The receiver, when he assumed his duties, was therefore confronted with the task of liquidating five banks.[2]

The control of several outside banks had been obtained through small outlays in order that, in the words of the receiver, "their good assets might be used and bad investments might be substituted therefor."[3]

This one experience indicates a danger which is present in both branch banking and chain banking, namely, that they may be used merely as a means for getting control of funds which are to be used for speculative purposes.

The speculative or dishonest motives, however, lying back of the California Safe Deposit and Trust Company expansion were not the only causes of the sudden growth of branch banking in San Francisco in 1906. The earthquake and fire of that year must share the responsibility. In fact, Wright, in his history of banking in California, speaking of branch banking in California, says:

Its advent here was due to the great calamity of that year, which temporarily put out of commission nearly every bank in the city, both large and small. This was not the worst feature of the situation. It drove the people and their places of business into the residence district

[1] Following the earthquake of 1906.

[2] *Annual Report* of the Board of Bank Commissioners of California, 1908, p. 21.

[3] *Ibid.*, pp. 24–25.

of the city. Even after the big fire had exhausted itself, and the vaults were sufficiently cooled to be opened with safety, what was left of the bank buildings in the burned districts was too remote from the stores to be conveniently reached. There was, therefore, no alternative but to open branches of the main offices in the new and temporary business sections. Several of the banks did this, some of them having even two branches and others three or four. This condition prevailed in San Francisco for three years, but before the close of 1909 practically all of these branches were abolished and the business centered once more at the main office.[1]

The report of the banking commissioners for 1907 shows that, from June, 1906, to June, 1907, eight new branches had been established in the city. Six banks had one branch each, and the California Safe Deposit and Trust Company and the Anglo-California Bank each had one additional branch. Besides these intracity branches, two San Francisco Japanese banks established branches in Los Angeles. The following year saw only one new branch established in San Francisco, while the two Japanese banks were placed in liquidation, as was also the California Safe Deposit and Trust Company. This reduced the number of branches by four and left only one outside branch of a San Francisco bank, the Oakland branch of the Banca Popolare Operaia Italiana.[2]

Outside San Francisco, only three banks established new branches in the year, June, 1906, to June, 1907. The San Ramon Valley Bank (Walnut Creek) established a branch at Danville; the Bank of Los Banos, a branch at Dos Palos; and the Bank of Shasta County (Redding), a branch at Kennet. The following year, six new branches were established outside San Francisco. They were the Forestville branch of the Analy Savings Bank (Sebastopol), the Kings City branch of the Monterey County Bank (Salinas City), the East Pasadena branch of the Crown City Bank (Pasadena), the San Mateo branch of the Bank of Burlingame (Burlingame), the Crockett branch of the Bank of Pinole, and the Oakland branch of the Banca Popolare Operaia Italiana (San Francisco).

[1] Wright, "Banking in California, 1849–1910," pp. 142–143.

[2] *Op. cit., passim.*

The following table summarizes the growth of branch banking during this early period:

GROWTH OF BRANCH BANKING IN CALIFORNIA, 1900–1908[1]

Date	Number of branches			Number of state banks		
	In San Francisco	Out-side	Total	Having branches	Other	Total
1900	..	2	2	2	246	248
1905	1	4	5	5	399	404
1906	4	6	10	8	441	449
1907	12	12	24	20	458	478
1908	8	11	19	18	469	487

[1] *Annual Reports* of the Board of Bank Commissioners California, 1900–1908, *passim.* Compiled by the writer. Since branch banking had no official status before 1903, it is quite possible that one or two branches existed in 1900, which do not appear in the reports of the commissioners.

Conclusions.—A number of general conclusions with regard to this early period are fairly obvious. First, the increase in the practice of branch banking was appreciable though not very rapid, as measured in absolute terms. Second, branch banking had little vogue in the large cities, while nearly all of the branches were held singly by country banks in various small towns of the state. Third, branch banking in San Francisco, to the limited extent that it existed, was largely a temporary expedient induced by the difficulties attendant upon the great fire of 1906, though some branches in the city were established for other reasons.

The rise and spread of branch banking during this period may be attributed to two main causes. The first of these is negative or passive in character, the lack of any legal hindrance to the establishment of branches. The second and positive reason is that various bankers became convinced that a branch located in a nearby town would form a valuable adjunct to their business. In other words, the profit-making motive seems to be the only sufficiently general motive to explain a movement participated in by such a number of small, scattered banks. It is hardly plausible that these small-town American bankers were merely imitating foreign

banking methods or that these branches represented a desire for power or personal aggrandizement. If branch banking had not been profitable, these small country banks would have been unable to maintain the branches and remain in business.[1]

[1] For the significance of these remarks, it may be advisable to compare the charges of the independent bankers as to the explanation of the growth of branch banking. *Cf. infra*, p. 104.

CHAPTER V

BRANCH-BANKING LEGISLATION IN CALIFORNIA, 1909–1925

THE CALIFORNIA BANK ACT OF 1909 AND AMENDMENTS

The period of prestatutory branch banking ended in 1909 with the passage of the California Bank Act. The complexity of the developments of the ensuing period favors a topical rather than a strictly chronological treatment. There were many changes in the law directly and indirectly applicable to the branch-banking business. The number of branches increased rapidly, and the characteristics of the business underwent profound changes.

Since this period is set apart from the preceding period chiefly by the change in the law under which branch banking was carried on, it seems advisable to give first attention to the legal situation. The method of obtaining new banking legislation in California is well described by Mr. Drum of the Mercantile Trust Company of California in his testimony before the House Committee in April, 1924.[1] The same conditions which, as a national matter, brought about the National Monetary Commission after the panic of 1907, brought in California the appointment of a legislative committee to examine the question of sound banking in that state. This committee took, first of all, the New York law as a model,

> "a law which had served largely as a model in the old days for the original national banking act and which had been amended in a flexible way to keep pace with the growth and development of financial power in the United States, the great percentage of which was lodged in New York."[1]

Besides this, they considered the progressive laws of all the other states and then drafted the Bank Act of 1909. This was a very

[1] Hearings before the Committee on Banking and Currency, House of Representatives, 68th Congress, 1st session, on H. R., 6,855 (Apr. 9, 15, 16, 18, 1924), pp. 80–81. (In subsequent references, the title of this report is abbreviated to *Hearings*.)

strict bill full of penalties. The California bankers, the state bank superintendent, and the state legislature felt that a sound banking system should begin with such a rigid bill but that

> "it should at every two-year period of the legislature be threshed out, discussed, investigated, and determined definitely whether a provision should be amended, eliminated, or left as it was, and this procedure was adopted."[1]

A legislative committee of the California Bankers' Association, after seeking the views of every banker in the state, met and conferred with the superintendent of banks for days or even weeks prior to each session of the legislature, to discuss improvements in the Bank Act.[2] The changes in law made during this period came only after this careful preliminary discussion, since the state legislature has been inclined to accept the advice of the superintendent of banks.[3]

Regulation.—The California Bank Act of 1909 brought about a reorganization of the state system of banking supervision, introduced "departmental banking," and gave definite statutory authority for the practice of branch banking. Since branch banking was already in existence in California, the essential change made by the act was regulative rather than permissive. This act, with numerous amendments, has governed branch banking in California from 1909 to the present time. The provisions relating directly or indirectly to branch banking may conveniently be discussed under the three headings: Conditions Governing the Opening of Branches, Assessments, and Stock Ownership and Consolidations.

CONDITIONS GOVERNING THE OPENING OF BRANCHES

The Bank Act of 1909 laid down two conditions for the opening of branches of banks: first, the written approval of the superintendent of banks and, second, additional required capital to the amount of $25,000 for each branch.

[1] Hearings, p. 81.
[2] Mr. Drum was chairman of this committee for fourteen years. Hearings, p. 113.
[3] Hearings, pp. 81–83.

Approval.—These provisions were contained in Section 9 of the act, as follows:[1]

No bank in this state, or any officer or director thereof, shall hereafter open or keep an office other than its principal place of business, without first having obtained the written approval of the superintendent of banks to the opening of such branch office, which written approval may be given or withheld in his discretion, and shall not be given by him until he has ascertained to his satisfaction that the public convenience and advantage will be promoted by the opening of such branch office; and, provided, *further*, that no bank or any officer or director thereof, shall open or maintain such branch unless the capital of such bank, actually paid in cash, shall exceed the amount required by this act by the sum of twenty-five thousand dollars for each branch office opened and maintained. Every bank, and every such officer or director violating the provisions of this section shall be guilty of a misdemeanor.

Capital.—The additional capital requirement provision is difficult to interpret, since the regular capital requirement consisted of two independent factors, an absolute minimum and a percentage of the deposits. It is probable that the additional capital was intended to be figured on the basis of the absolute minimum. The Act of 1895 had laid down minimum capital requirements based on differences in population, similar to the provisions of the National Bank Act. As a result of adverse court rulings,[2] this basis had been abandoned, and the act of 1907 had required simply that the capital must equal "at least 10 per cent of the total amount owing to the depositors, banks, and bankers, and to its creditors by such bank or banking corporation" and further provided that $25,000 should be the minimum capitalization and that $1,000,000 should be the maximum required of any bank.[3]

In this matter, the Act of 1909 followed closely the provisions of the previous act. The aggregate capital and surplus were to be equal to 10 per cent of the bank's deposit liabilities and not less than the minimum of $25,000 for either a savings bank or a commercial bank or less than $200,000 for a trust company. A bank combining the savings and commercial functions was required

[1] California Bank Act, 1909, Sec. 9.

[2] Wright, "Banking in California," p. 141.

[3] Act cited, Sec. 19*a*.

to have only $25,000 as a minimum capitalization, but a bank combining either or both of these functions with the trust function had to have a capitalization of at least $225,000.[1] Apparently, therefore, the additional capital required for the establishment of a branch would apply to this minimum capitalization, and this would mean that a commercial and savings bank would need at least $50,000 capital and surplus in order to establish one branch.

If it is assumed that a higher required capitalization is burdensome, no advantage can be said to have been given to branch banking by this law, except in regard to the exercise of trust powers, for two independent banks, exercising both trust and commercial and/or savings functions, would be compelled to have $225,000 capital for each or a total of $450,000 for the two, while a new branch might have been opened by either of the banks, merely increasing its own capital by $25,000, making a total for the two offices of only $250,000.

The amendments to the Bank Act in 1911 reintroduced the population principle for grading capital requirements for all departments except the trust department, where the fixed minimum of $200,000 was retained.[2] The classification was not to apply to any bank already in existence which had received its certificate to do a banking business from the superintendent of banks.[3] No change in the provisions for branches was made. The 1913 amendments lowered the absolute minimum for trust companies and trust departments for the smaller towns from $200,000 to $100,000, and appropriate changes were made in the capital for departmental banks.[4] Otherwise, the graduations were the same as in the 1911 act. The requirements are shown in the table below.

Another modification made by the 1913 act was in regard to the percentage capital requirement as applied to savings banks. For savings banks with deposits of less than $2,000,000 the capital and surplus were to constitute at least ten per cent of the deposits. With increasing amounts of deposits, the required percentage against the increased amount of deposits declined gradually to as

[1] Bank Act, 1909, Secs. 19, 60, 82, 90, 23.

[2] Bank Act, 1911, Secs. 23, 60, 82.

[3] Bank Act, 1911, Sec. 23.

[4] Bank Act, 1913, Secs. 23, 60, 82, 90.

low as 1 per cent for the deposits above $40,000,000.[1] This did not apply to trust and commercial departments.

CAPITAL REQUIREMENTS, 1913[1]

Population	Single function		Departmental	
	Commercial or savings	Trust	Commercial and savings	Trust and commercial and/or savings
5,000 or less..........	$ 25,000	$100,000	$ 25,000	$125,000
25,000 or less.........	50,000	100,000	50,000	150,000
100,000 or less........	100,000	100,000	100,000	200,000
200,000 or less........	200,000	200,000	200,000	400,000
Over 200,000..........	300,000	200,000	300,000	500,000

[1] Bank Act, 1913, Secs. 23, 60, 82, 90.

Fee.—This act made a further change in the matter of opening new branches. The law in 1909 had required the obtaining of a certificate of authority from the superintendent of banks and had made it a misdemeanor to open a branch without such a certificate. According to the new provision, a fee of $50 was to be levied for each certificate, and in place of the misdemeanor charge, the act provided that $100 should be forfeited to the state for every day "which any branch office hereafter opened shall be maintained without such written approval."[2]

These changes, with the exception of the new $50 fee, were generally favorable to the extension of branch banking, since the $25,000 additional capital requirement for the establishment of a branch remained, while the minimum capital requirements for independent banks in all except the smallest class of communities were fixed at higher figures. The importance of this discrimination, however, tended to be minimized by the practice of the superintendent of banks in giving certificates of authorization for out-of-town branches only where an independent bank had been bought out.[3] The provision for grading the capital requirements for savings banks and savings departments of departmental banks, through lowering the percentage as the amount of deposits

[1] See table, *infra*, p. 42.

[2] Bank Act, 1913, Sec. 9.

[3] Hearings, April, 1924, p. 150, testimony of Mr. Oliver.

increased, very definitely favored the branch-banking systems, since the branch banks in California are largely engaged in the savings-bank business and since branch banks tend to be larger institutions than the independent or unit banks.[1]

No change in capital requirements was made by the act of 1915. The amendments to the Bank Act in 1917 removed, in part, at least, the discrimination against independent banking which had been involved in the straight $25,000 requirement for a branch office, as contrasted with the capital requirement graded according to population for the independent bank. The new requirement made it necessary for a bank which wished to establish a new branch to have an additional capital equal to the amount required for the establishment of a new bank in the place where the branch was to be located. This new rule, however, did not apply to branches established in the same city as the parent bank or to branches established by trust companies. A trust company was still permitted to establish a branch either in the home city or outside with only a $25,000 increase in capital. Departmental banks with trust departments were also exempted from the population requirement for independent trust companies, in their establishment of branches.[2] For the branches established in the home city of the parent bank, the requirement remained at $25,000, the amount required for all branches in the earlier act. For out-of-town branches the law now required a capitalization according to the population, but even in the largest cities a bank with its head office in the city might establish branches with only $25,000 additional capitalization for each.[3] Thus, this new provision marks definitely the contrast between city and out-of-town branches. These simple provisions logically prescribe a definite development of the banking system, first, the elimination of small independent banks within the limits of any large city, since a large capital is required by law, and second, the location of parent banks in the larger cities of the state with branches in the smaller towns, since the capital for the branch must meet the local requirement and a bank would be unlikely to establish a branch with a larger capital requirement than that

[1] *Ibid.*, p. 184.

[2] Bank Act, 1917, Sec. 9.

[3] *Ibid.*

of the parent bank. To avoid any misconstruction, it should be noted that the law does not require the actual assigning of any part of the additional capital to the branch for its operations.

Only a minor change and one not affecting the branch-banking situation was brought by the Act of 1919. Government deposits in savings banks, when properly secured as required by law, were not to be included in the deposit liabilities for computing the required capital.[1] In 1921, however, an important change was made. The practice of fixing the minimum capital as a proportion of deposits had persisted since its adoption, and, as previously noted, in 1913, the proportion required for savings banks was made smaller as the deposits increased. This principle was now applied to commercial deposits as well, though the graduations were not so numerous nor did they reach such a low percentage. The aggregate of paid-up capital and surplus of every commercial bank was required to equal the following percentages of its deposit liabilities: 10 per cent of any amount up to and including $2,000,000, 7½ per cent of any amount above $2,000,000 and not above $5,000,000, 5 per cent of any amount in excess of $5,000,000.[2]

At the same time, the requirements for savings banks were reduced by lowering the amount of deposits required for the application of the scale of percentages, as shown in the following table:

Percentage Capital Requirements for Savings Banks[1]

Scale in per cent	Amount of deposits, in millions of dollars	
	1913	1921
10	up to 2	up to 1
7.5	from 2 to 5	from 1 to 3
5	from 5 to 15	from 3 to 10
2.5	from 15 to 40	from 10 to 25
1	above 40	above 25

[1] Bank Act, 1921, Sec. 19; *cf.*, also, Bank Act, 1913, Sec. 19.

Both of these changes would operate in favor of branch-banking systems, since they resulted in lower capital requirements

[1] Bank Act, 1919, Sec. 19.

[2] Bank Act, 1921, Sec. 19.

for banks with large deposit totals. So far as the savings-bank requirements, however, started with low or lower amounts of deposits as the basis of the graduation, the larger of the independent banks were also aided.

Changes Made by Act of 1923.—The act of 1923 made several changes in the direction of eliminating this favoritism. A slight change was made in the percentage of deposits-capital scale, simplifying, and, at the same time, lowering the requirements.

PERCENTAGE CAPITAL REQUIREMENTS IN 1923[1]

Savings banks		Commercial banks	
Per cent	Deposits in millions of dollars	Per cent	Deposits in millions of dollars
10	Up to 1	10	Up to 1
5	From 1 to 3	5	Above 1
3	From 3 to 25		
1	Above 25		

[1] Bank Act, 1923, Sec. 19.

This, like the previous changes, had a mixed effect of favoring the larger of the independent banks along with the branch banks. The very low starting point would obviously be greatly to the advantage of the independent banks.

The important change made by the act was one directly applicable to the maintenance of branches. The following new clause was added to the section prescribing the percentage capital requirements:

> Any bank which maintains branch offices must, for each respective department, maintain an aggregate of paid-up capital and surplus equal to the foregoing percentages of its deposit liabilities, calculated on the basis of a separate total of such deposit liabilities for each city or town in which any such branch office may be maintained.[1]

This change carries still further the distinction already made in the treatment of intracity and out-of-town branches. The general effect of the change is to increase the required capital for large branch-banking systems, though the fact that the deposits

[1] Bank Act, 1923, Sec. 19.

are to be computed on a city or town basis, rather than for the individual branch, leaves the independent bank still in an inferior position.

Another change brought about by this Act of 1923 has to do with the establishment of new banks in localities which have been included by annexation or consolidation within the limits of cities requiring a larger capitalization. Under the law of 1913,[1] banks already in existence in such annexed territories were not required to increase their capital unless they wished to establish branches or to move out of the district, but the new law allowed the superintendent of banks to authorize the establishment of new banks in such districts with the same minimum capital as would have been required if the section had not been annexed.[2]

This is, on the very face of it, an attempt to make possible the existence of unit banks in the face of branch-office competition in the large cities. The necessity for some such provision lies in the fact that the $300,000 required capital for banks in cities of more than 200,000 inhabitants is clearly excessive for a mere suburban bank. Obviously, the remedy is somewhat inadequate, since many suburban sections which might properly support such a small bank could not qualify under the terms "annexed or consolidated localities."[3]

APPORTIONMENT OF BANKING-DEPARTMENT EXPENSES

The banks in California have been obliged to provide the funds to support the state banking department. In view of the differences in size and method of conducting business, the basis of assessment must be carefully considered, if inequalities are to be avoided. As far as possible, the charge upon a bank should be proportional to the amount of services performed for it by the banking department.

Deposits Basis.—From the inception of state supervision, in 1878, until the year 1905, the assessments to meet the annual expenses of the bank commissioners were prorated on the basis of

[1] Bank Act, 1913, Sec. 23.

[2] Bank Act, 1923, Sec. 23.

[3] For the development under this provision, it is sufficient to say that there have been several such small banks formed in Los Angeles in the last few years. *Cf. Annual Report* of the Superintendent of Banks of California, 1925, *passim.*

deposits. In 1905, an annual license fee of $40 for each bank was provided for. The remainder of the expenses were to be prorated on the basis of deposits.[1] While a minimum charge seems to be a logical and proper arrangement, still, it would seem that $40 is unduly high and that the small banks might have ground for complaint. At any rate, the Act of 1909 marked a reversal to the original rule of apportioning all of the expenses on the basis of deposits.[2]

Capital and Surplus.—An entirely new provision was adopted in 1913.[3] Instead of using deposits as the basis for the apportionment, the new clause made capital and surplus, "which shall include all reserve and contingent funds," the basis. Under the former law, whch had made capital and surplus, as a minimum, merely a fixed percentage of the deposits, it would have made little difference as to which basis was chosen. The 1913 law, however, not only introduced the population principle in grading the required minimum capitalizations but also altered the percentage requirement from a fixed percentage of 10 per cent to a scale of percentages with lower requirements as the amount of deposits increased. At first, this applied only to savings deposits, but in 1921 it was applied also to commercial deposits.[4] Because of the change in the method of fixing the minimum capitalization, the new basis of assessment bore more heavily on the smaller banks. Hence, branch banking, which is naturally conducted by larger banks, was favored.

Flat Charge for Extra Services.—In another way, also, this act favored branch banking. It provided for a maximum flat charge of $20 a day for extra services of the department to a bank.[5] This would obviously be unfair to the smaller banks, if, in any particular case, the $20 a day should prove actually insufficient to meet the cost to the department of an extra examination of a large bank with numerous branches. This section was altered in 1919 to eliminate the advantage to branch-banking systems. This was done by adding the following clause:

[1] Bank Act, 1903, Sec. 15, as amended in 1905.
[2] Bank Act, 1909, Sec. 123.
[3] Bank Act, 1913, Sec. 123.
[4] *Supra*, p. 42.
[5] Bank Act, 1913., Sec. 124.

and such bank shall pay for all such extra services rendered by the superintendent of banks at a price to be fixed by the superintendent of banks but not to exceed twenty dollars per day for the examination of the principal office of such bank and twenty dollars per day for the examination of each branch office of such bank.[1]

The Act of 1923 removed many elements of discrimination against unit banking. The superintendent of banks had recommended that total assets or resources be used as the basis of the apportionment of banking department expenses

> . . . providing, however, that no bank shall pay less than a certain minimum assessment and that each bank having a branch office or branch offices also pay an additional assessment for each branch office.[2]

The section as finally adopted by the Legislature was similar in effect though not so logical or so comprehensive. The section read, in part:

> Each bank shall pay annually a sum not to exceed one one-hundredth of one per centum of its total capital, surplus, reserve and contingent funds, undivided profits, and deposits but not including secured deposits of public moneys, as shown by the last report of such bank to the superintendent of banks.[3]

The reintroduction of deposits as a base, even though combined with capital and surplus, eliminated in large measure the unfairness involved in the exclusive dependence upon capital and surplus which, at least as a legal minimum, are proportionally smaller for the larger banks. The failure to include in the law the superintendent's recommendation for an additional assessment for each branch office seems unwarranted, since as between two banks of the same size the cost of banking-department services would clearly be greater for the bank which has branches.

LEGAL STATUS OF STOCK OWNERSHIP AND BANK CONSOLIDATIONS

Since branches may be acquired through the purchase of existing institutions, the legal conditions governing stock ownership and the consolidation of banks are of significance. In 1905, the

[1] Bank Act, 1919, Sec. 124.

[2] *Annual Report* of the Superintendent of Banks of California, 1922, p. 17.

[3] Bank Act, 1923, Sec. 123.

Attorney General of the state ruled that, under the decisions of the courts, California banks had no power to purchase stock in another corporation.[1] The Bank Act of 1909 specifically provided that no bank might purchase the shares of corporations, "unless such purchase shall be necessary to prevent loss on debts previously contracted in good faith."[2] Even this power of acquiring shares indirectly was limited by a further provision that no bank might hold more than 10 per cent of the stock of another bank as collateral for loans.[3] The percentage of the stock of another bank which might be held as collateral was increased to 25 per cent by the act of 1913, and the following clause was added:

> . . . and provided, further, that no bank may loan more than five per centum of its assets upon the capital stock of any corporation whatsoever as collateral security.[4]

These provisions prevent the direct purchase of the shares of other banks and also prevent directors, officers, and others from borrowing from the parent-bank-to-be enough funds on bank-stock collateral to gain a full controlling interest in the bank to be acquired. Nevertheless, the power to pledge one-fourth of the stock of the bank which is being bought is not a negligible factor in an aggressive expansion policy.

For the sake of completeness, it may be said that the prohibition of bank-stock ownership was lifted slightly in 1919 in order to allow a bank to purchase and hold the whole or any part of the capital stock of not more than one trust company in the same city as the bank itself. Under like terms, a bank was permitted to own a safe-deposit company. Not more than 25 per cent of the bank's capital and surplus were to be invested in the trust company and not more than 10 per cent in the safe-deposit company.[5] This privilege could be exercised only with the previous written consent of the superintendent of banks, who comments on the change in law as follows:

[1] Banking Laws of California, compiled by Commissioner Blackstock, 1907, p. 186.

[2] Bank Act, 1909, Sec. 37.

[3] Bank Act, 1909, Sec. 44.

[4] Bank Act, 1913, Sec. 44.

[5] Bank Act, 1919, Sec. 37.

> The change is intended to strengthen our trust companies and also to indulge smaller banks in a desire to participate in the profits of these companies.[1]

This is related to the branch-banking situation, since several small banks might thus establish a trust company to compete with the branch bank which exercises the trust function.

Touching on the branch-banking problem more specifically is the provision relating to consolidation of banks. The Act of 1909 had provided an indirect, but very effective, means of consolidation by permitting the sale of the whole or any portion of the assets of one bank to another bank with the consent of two-thirds of the stock of each bank.[2] Such a definite provision of the law makes possible the acquisition of small banks for use as branches without paying exorbitant prices to minority stockholders.

Two amendments have been made to this section dealing with the combination of banks. The 1913 law added a specific provision for the consolidation of banks. "Any bank incorporated under the laws of this state may consolidate with one or more banks incorporated under the laws of this state."[3] The second amendment came in 1921 and provided for the merging of banks.[4] There are, therefore, at present, three methods of combining banks in California, first, purchase of assets, second, consolidation, and third, merger. In every case, the combination is subject to the approval of the superintendent of banks and may take place only with the consent of the holders of two-thirds of the stock of each of the combining banks. No grounds for approval are suggested in the law, and it is, therefore, not clear as to the amount of discretion which the superintendent of banks may exercise in granting or withholding his approval. Presumably, such approval would be granted if all the terms of the law had been complied with. It does not seem probable that the superintendent of banks could use this discretionary power to check the spread of branch banking through consolidations, even if he should wish to do so, at least, unless he could show that

[1] *Annual Report* of the Superintendent of Banks of California, 1919, p. 17.
[2] Bank Act, 1909, Sec. 31.
[3] Bank Act, 1913, Sec. 31*a*.
[4] Bank Act, 1921, Sec. 31*b*.

such a consolidation was seriously endangering the bank's creditors or minority stockholders.

ATTITUDE OF THE SUPERINTENDENTS OF BANKS

Both in regard to proposed legislation and to the effect of legislation actually enacted, the official viewpoint or attitude is of significance. As the superintendent states in his 1916 report, the statute places no limit on the number or the locality of branch offices. That is left entirely to the discretion of the superintendent of banks.[1] Unless he thinks that the "public convenience and advantage will be promoted, no license must be granted."[2] In this same report, the superintendent enumerates three reasons or motives which affect the granting of such licenses. First, in regard to city branches:

> Without the expedient of licensing branch offices some of the more remote and isolated districts would be deprived of banking accommodation because of the capital required by the classification of the larger cities.

Second, in regard to out-of-town branches:

> These branch offices offer to the communities in which they are licensed greater assistance, larger loans, and more extended credit than local institutions can afford.

Third:

> Still another cause has often influenced my course in granting the desired license. Occasionally it happens that the general banking tone of a community will measurably be improved by the licensing of a branch office of a well-established, safely conducted institution.[3]

In this report, also, he recommended that the superintendent of banks be given power to control the abandonment as well as the establishment of branches. Another recommendation was that the capital requirement for the establishing of branches be raised to a point more in harmony with the capital classification for new banks.[4] These recommendations, with changes, were

[1] *Annual Report,* 1916, p. vii.

[2] *Ibid.*

[3] *Ibid.,* pp. vii–viii.

[4] *Annual Report,* 1916, p. viii.

enacted into law the following year. The chief change made from the recommendations was the distinction drawn between city and out-of-town branches. The higher capitalization was required only for the latter.[1]

The following quotation indicates clearly the attitude of the banking department in 1918:

> One of the most seriously considered and important activities of the state banking department during this period has been the elaboration of its theory of the essential character and value of branch offices in the state banking system. For many years such offices were licensed simply to serve the convenience of the public in the political subdivision in which was located the main office of the bank.[2] Each branch office possessed no further utility than that of an additional teller's window. The broader economic service of the branch office was unthought of until branch offices, under distinct authority of the statute, were licensed in territory remote from the principal place of business of the bank in districts in no geographical sense contributory either financially or economically to the main bank.[3]

This represents an attitude very definitely favorable to branch-banking development. In the same report, however, a recommendation was made that the maximum legal charge for the examination of branch offices be raised, since the existing charge was inadequate to cover the expenses of such examinations.[4] This recommendation also, was enacted into law.[5]

Several references to consolidations and mergers in the 1920 and 1921 reports are significant in themselves and also as indicative of the official attitude.

> One of the interesting developments of the year was the consolidation of large and prosperous banking institutions into larger and more efficient units. Through this process six state banks became extinct and were merged into new institutions more adequately conditioned to meet the needs of their contributory territory.[6]

[1] *Annual Report*, 1917, p. ix, also, *supra*, p. 40.
[2] Ed. note: This seems too broad a generalization. *Cf. supra*, p. 30.
[3] *Annual Report*, 1918, p. 10.
[4] *Annual Report*, 1918, p. 24.
[5] *Annual Report*, 1919, p. 23, *supra*, p. 45.
[6] *Annual Report*, 1920, p. 28.

In the 1921 report, reference is made to the sale of assets of eleven banks and the subsequent absorption, "the process being representative of the development of the branch-office banking theory."[1] The following comment is still more illuminating:

> This merging of assets and of banking power in a territory that has the same economic objectives is unquestionably a splendid development of banking capacity . . . In the distribution of credit with a knowledge of the needs of every part of the territory involved, far better results may be accomplished than through the agency of many smaller institutions consuming much of their profit in overhead expense.[2]

In the 1922 report the superintendent pointed out the inequality which resulted from the assessment for the expenses of the department on the basis of capital and surplus in view of the higher ratio of capital to deposits in the smaller banks. As noted above,[3] he recommended that the assessment be on the basis of total resources and that there be a minimum assessment for any bank and an additional assessment for each branch office. This proposal represents a desire for equality among the different types of institutions. Nevertheless, the superintendent definitely favors branch-banking development.

> Branch banking, under certain conditions and limitations, has been so long permitted and practiced under the laws of this state, as well as in other countries and states, that it can no longer be considered an experiment.[4]

He continues along the same line, presenting arguments in favor of branch banking. This indicates, to a certain extent, a defensive attitude, since, by this time, branch banking was the object of an active attack by the organization of the independent bankers and the Comptroller of the Currency.[5]

SUMMARY OF THE DISCUSSION OF LEGISLATIVE CHANGES

During this period, the legislation applicable to branch banking has been carefully and systematically developed, defining the

[1] *Annual Report*, 1921, p. 42.

[2] *Ibid.*

[3] *Supra*, p. 46.

[4] *Annual Report*, 1922, p. 12.

[5] *Infra*, p. 69; *cf.*, also, *Report* of the Comptroller of the Currency (Mr. Dawes), 1923, pp. 3–17.

terms under which branch banking may be practiced, bringing the whole matter under the supervision and control of the banking department, and tending, in general, to eliminate legislative discrimination against either unit or branch banking. The attitude of the state banking department has always been definitely favorable to branch-banking development, though not at the expense of unit banks.

CHAPTER VI

THE GROWTH OF BRANCH BANKING IN CALIFORNIA UNDER THE BANK ACT OF 1909 AND ITS AMENDMENTS

The increase in branch banking up to the year 1909 had been comparatively slow, for there were only 29 or 30 branches by the middle of that year, while there were 456 banks in the state system. By June 30, 1924, the number of branches had increased to 509, while the number of banks had declined to 410. In accordance with the rate of growth, this period is logically divided into two parts, the first, of eleven years, extending from 1909 to 1920, during which the growth was steady but not spectacular, with an average increase of about 12 branches a year; and the second, of four years, from 1920 to 1924, during which a very rapid growth took place, with an average increase of 85 branches a year.[1]

THE PERIOD OF SLOW GROWTH, 1909–1920

In 1910, two Los Angeles banks had branches in the city. One of these had three branches, while the other had but one branch. The situation in San Francisco was similar; three banks were engaged in branch banking, and of these one had three branches and the others two branches each in the city. Besides these city branches, two San Francisco banks had one branch each outside the city limits. The remainder of the thirty-six branches in the state were held by banks in the small cities and towns outside San Francisco and Los Angeles. Only one of these country banks had more than one branch, and this bank had only two branches.

The following table shows the situation as regards the yearly increase in number of branches compared with the increase in

[1] *Annual Reports* of the Superintendent of Banks of California, 1909 to 1925, inclusive. The figures have been compiled by the writer.

state banks for the period 1910 to 1925.[1] (The figures are for June 30, in most cases, though the range is from June 4 to 30.)

Date	Banks	Branches	Date	Banks	Branches	Date	Banks	Branches
1910	455	36	1915	468	95	1920	420	167
1911	452	50	1916	460	105	1921	423	193
1912	455	64	1917	448	126	1922	429	281
1913	468	80	1918	430	148	1923	429	440
1914	473	77	1919	425	146	1924	410	509
						1925	394	556

By 1920, six Los Angeles banks had a total of twenty-eight branches in the city. The Home and Hibernian Bank (now the California Bank) had fifteen of these branches. The other banks were about equal in their participation, though two of the other banks had already started an out-of-the-city expansion in a small way, with two branches each. The situation is shown in the following table:

Los Angeles Banks with Branches, June 30, 1920

Name of bank	Number of branches in Los Angeles	Location and number of other branches	Total
Home and Hibernian Bank.....	15	0	15
Los Angeles Trust and Savings Bank......................	4	1 Catalina Island 1 Huntington Park	6
Hellman Commercial Trust and Savings Bank..............	3	1 Riverside 1 Blythe	5
Security Trust and Savings Bank	3	0	3
Citizens Trust and Savings Bank	2	0	2
Guaranty Trust and Savings Bank......................	1	0	1
Six banks in all.............	28	4	32

The increase in branch banking in Los Angeles from 1910 to 1920 was marked, being an increase from four branches to twenty-eight in the city itself, besides the four new branches established

[1] This and subsequent tables compiled from *Annual Reports*, *passim.*

by Los Angeles banks outside the city. In San Francisco the increase during the period was much less, for by 1920 there were only twelve branches in the city as compared with seven in 1910. This does not, however, measure the full extent of the San Francisco banks' participation in the movement, since the Bank of Italy had launched a program of out-of-the-city expansion and had established twenty-two branches outside the city. Several other San Francisco banks, also, had outside branches. The situation is presented more distinctly in the following table:

San Francisco Banks with Branches, June 30, 1920

Name of bank	Number of branches in San Francisco	Number and location of other branches	Total
Bank of Italy	3	4 in Oakland 3 in Los Angeles 15 in 15 other places	25
Banca Popolare Fugazi	1	1 in Oakland 1 in Santa Barbara	3
Anglo-California Trust Company	3	0	3
The San Francisco Savings and Loan Society	3	0	3
First Federal Trust Company	1	0	1
Italian-American Bank	1	0	1
Portuguese American Bank of San Francisco	0	1 in Oakland	1
The Yokohama Specie Bank	0	1 in Los Angeles	1
General Motors Acceptance Corporation[1]	0	1 in Los Angeles	1
Total of 9 institutions	12	27	39

[1] The acceptance corporation does not receive deposits and is a bank in only a very limited sense.

Country Banks.—Not only did the Bank of Italy stand alone as the only city bank with a large number of country branches, but it was also the only bank of any sort with a large number of such branches, since none of the country banks had built up extensive systems. Nevertheless, it is not to be assumed that the

country banks took no part in the movement. The number of branches of banks with head offices outside Los Angeles and San Francisco had increased from twenty-three, in 1910, to ninety-six, in 1920.[1] This increase took place as the result of the activity of numerous country banks rather than through the expansion of the few original systems. Only one such bank had as many as five branches. This was a San Diego bank. Another bank had four branches. This was a bank in San Jose. All the remainder of the branches were held in small one-, two-, or three-branch systems.

COUNTRY BANK SYSTEMS, JUNE 30, 1920

Parent banks	Branches in a system	To tal branches
37	1	37
19	2	38
4	3	12
1	4	4
1	5	5
62		96

Since some of the cities outside the two previously mentioned, San Francisco and Los Angeles, are of considerable size, such as Oakland, San Diego, Sacramento, Berkeley, etc., it is desirable to consider the amount of intracity branch banking practiced by these so-called "country banks." Out of the ninety-six branches shown above, only fifteen were located in the same city or town with the parent bank. These were held as follows: eight banks with one local branch each, two banks with two local branches each, and one bank with three such branches. Nine of these banks with such local branches had no branches outside the parent-bank town. One bank had two local branches and one out-of-town branch, and two banks had one local and one out-of-town.

[1] Figures for Oakland are included in the following tabulations, even though Oakland is a reserve city for national banks. Three banks there had four branches in Oakland and two in Berkeley, in 1920. The development is too slight to warrant separate treatment.

The distribution of the parent banks is a significant matter. Only one town was the home of as many as three of the parent banks, namely Oakland. Seven towns were headquarters for two such country systems each. Forty-five towns had just one parent bank in each. This indicates a very high degree of decentralization in the movement as far as the country banks are concerned. This situation with regard to the country banks makes the position of the city banks, such as the Bank of Italy, still more exceptional, since a tendency to centralization is the most outstanding characteristic of their expansion.

The distribution of branches according to the location of the parent bank is shown in the following table:

NUMBER OF BANKS[1] AND BRANCHES, 1910–1925[2]

Year	San Francisco		Los Angeles		Oakland		All other	
	Banks	Branches	Banks	Branches	Banks	Branches	Banks	Branches
1910	42		32		19		491	
1914	28	15	22	14	13	3	410	45
1920	29	39	16	32	6	6	369	90
1921	29	46	19	45	6	6	369	96
1922	29	75	17	96	6	9	377	101
1923	30	145	23	162	5	23	371	110
1924	27	170	22	214	5	23	356	102
1925	28	200	24	239	3	10	339	107

[1] *Banks* includes all state banks, not merely parent banks.

[2] To avoid repetition later, this table has been carried on from 1920 to 1925 inclusive. The discussion of the later period will be found on pages 59–65, *infra*.

Even as late as 1920, the country banks formed an important, not to say predominant, element in the branch-banking development in California. A second and most rapidly growing element consisted of a small group of city banks with branches largely confined to city limits, though in this group the Bank of Italy constituted an important exception to the rule, with its 22 out-of-town branches. A growing concentration of control is indicated by the fact that nine of the more important Los Angeles and San Francisco banks were operating 61 branches, while all of the other banks engaged in branch banking in California, 68 in number, operated only 106 branches. Out of the total of 420 state banks in the state, there were 77 engaged in branch banking, approximately 18 per cent.

REASONS FOR THE GROWTH OF BRANCH BANKING IN CALIFORNIA DURING THIS PERIOD, 1910–1920

The explanation of the gradual and diffused growth of branch banking in California from 1910 to 1920 lies in the general acceptance by widely scattered groups of bankers of the idea that branch banking is profitable. Moreover, the gradual and continuous growth indicates that this idea was well grounded. A ten-year period is long enough to test the profitableness of the policy and if losses had been experienced, the growth would at the least have been checked.

While there were many banks engaged in branch banking, the Bank of Italy stands by itself in the aggressive expansion policy followed. This policy was consciously directed to the end of making the Bank of Italy a state-wide branch-banking system.[1] The other large city banks were slow in following the Bank of Italy in this acquisition of outside branches. The reason for this slowness appears to have been a desire on the part of the city bankers not to disturb the then-existing correspondent relationships. Even with the present great expansion of country branch systems of rival city banks, at least one of the large San Francisco banks prefers the correspondent relationship to that of parent bank to branch.[2] The Bank of Italy, as a new and small bank in 1909 and 1910 when it started its outward expansion, had no correspondents to lose, and it had much to gain by launching a program which would increase its resources rapidly without the delay involved in soliciting country bank correspondents. To go out and buy a small country bank and to set it up as a branch was a simple matter as compared with persuading such a bank to enter into the correspondent relationship with a small new city bank. So far as the Bank of Italy established its out-of-town branches by purchasing existing country banks, and this was the general rule,[3] the correspondents of those banks

[1] *Bankitaly Life*, November, 1923, p. 7.

[2] The Wells Fargo Bank and Union Trust Company; *cf.* Hearings, April, 1924, p. 92.

[3] Bank of Italy Petition for Writ of Mandate, S. F. 11,645, in the Supreme Court of the State of California, p. 14. Only twenty *de novo* branches were established out of a total of 103 branches. (Most of the *de novo* branches were established in San Francisco.)

converted into branches suffered a loss, for the branch carried accounts with no one except the parent bank. In an article on A. P. Giannini, the founder of the Bank of Italy, B. C. Forbes says:

> Born fighter though he was and is, A. P. Giannini found himself up against the fight of his life when he invaded the branch banking arena, and there were times when obstacles hurled in his way seemed insurmountable. He was fought by other California banks in the reserve centers, because it meant the loss of an account each time he took over an established institution.[1]

This is reprinted in *Bankitaly Life* and obviously represents the view of the Bank of Italy in the matter. Since the Bank of Italy had established only twenty-two out-of-town branches by 1920, the pressure on the other banks had not been great, but the growth had been steady and was sufficient to show the future trend. It was time for the reserve city banks to take some action if they wished to retain the country business.

PERIOD OF RAPID GROWTH, 1920–1924

The change in the situation became noticeable by the middle of 1920. The Great War was a thing of the past. Business and banking were getting back into normal channels and away from war conditions and the difficulties of government finance. There had actually been a decline of two branches in the year ending at mid-1919, but in the ensuing year the number of branches increased by 21, not an unprecedented increase, to be sure, since it had been equaled in 1916–1917 and surpassed by one in 1917–1918. This proved, however, to be the beginning of a very rapid movement. The net increase in 1920–1921 was 26. The increases of these two years were small as compared with what followed, for the total number of branches jumped from 193 on June 30, 1921, to 281 on June 30, 1922, an increase of 88 branches, about a 45.5 per cent increase, a percentage increase not equaled previously, since the first authentic records, at least. The increase

[1] FORBES, B. C., "A. P. Giannini: The Story of an Unusual Career," in *Forbes Magazine*, Nov. 10, 1923. Reprinted in *Bankitaly Life*, vol. 7, No. 11, November, 1923.

for the following year, however, far surpassed this record both in numbers and as a percentage of the total number of branches in existence at the beginning of the year. The figures are 159 branches and 53 per cent. Such a rate of growth could not long be maintained. In fact, the following year, mid-1923 to mid-1924, saw an increase of only 69 branches, a percentage of less than 16. Still more important, this year witnessed the first important recession in the number of branches of banks which were themselves located outside the reserve cities. There were 110 such branches of country banks in 1923 and only 102 in 1924. Clearly, the country branch systems were being absorbed by the city systems more rapidly than the remaining country systems were expanding.

Dominance of City Systems.—The keynote of this period is, therefore, the growing dominance of the city systems. San Francisco banks starting with 39 branches, in 1920, had 170 branches by 1924; the Los Angeles banks had 32 branches in 1920 and 214 in 1924; and the Oakland banks had increased their branches from 6 to 23. In the meantime, all other branches had increased merely from 90, in 1920, to a peak of 110 in 1923, then dropping back to 102 in 1924, a net increase of 22 for the four-year period as compared with 320 for the city banks in the same period. This is not to be misconstrued to mean a relative decline in branches located in the country but rather a shift in the ownership of such branches from the small country banks to a few large city systems.

Los Angeles.—The Los Angeles banks engaged in branch banking had increased from six to seven, though two of these parent banks had only three branches for the two of them. On the other hand, the Pacific-Southwest Trust and Savings Bank had built up a huge system, with thirty-five city branches and fifty-two country branches. The Security Trust and Savings Bank, with a total of thirty-nine branches, twenty-three in Los Angeles and sixteen outside, stood next in point of size. The following table shows the situation in regard to branches of Los Angeles banks both for the year 1924 and the year 1925:[1]

[1] *Annual Reports* of the Superintendent of Banks of California, 1924, 1925, *passim.* Compiled.

LOS ANGELES BANKS WITH BRANCHES

Name of bank	June, 1924				June, 1925			
	Number of branches			Number of towns	Number of branches			Number of towns
	City	Other	All		City	Other	All	
Pacific-Southwest Trust and Savings Bank......	35	53	87	43	43	47	90	41
Security Trust and Savings Bank..................	23	16	39	12	26	16	42	12
California Bank..........	34	2	36	2	36	2	38	2
Hellman Commercial Trust and Savings Bank	25	5	30	5	27	7	34	6
Citizens Trust and Savings Bank..................	19	..	19	..	21	1	22	1
Bank of America.........	1	..	1	..	4	6	10	6
Citizens State Bank of Sawtelle..............	2	..	2	..	2	..	2	
Central Commercial and Savings Bank of Los Angeles...............	..	..	..	..	1	..	1	
Totals for the seven banks in 1924 and eight in 1925......	139	75	214	62	160	79	239	68

San Francisco.—The situation in San Francisco was similar, though the growth in number of city branches was much less. The number of parent banks had increased from nine to twelve, though here, as in Los Angeles, the movement was not participated in equally by the various banks. Two San Francisco banks assumed dominant roles, the Bank of Italy and the Mercantile Trust Company of California. The former had sixteen branches in the city and seventy-two branches in fifty-seven towns outside San Francisco. The Mercantile Trust Company had twenty-eight branches in the city and twenty-six in nineteen other cities and towns. The situation for San Francisco banks is shown by the following table, in which the years 1924 and 1925 are compared:

San Francisco Banks with Branches

Name of bank	June, 1924 Number of branches City	Other	All	Towns	June, 1925 Number of branches City	Other	All	Towns
Bank of Italy	16	72	88	57	17	78	95	65
Mercantile Trust Company of California	28	26	54	19	28	27	55	19
United Bank and Trust Company of California	..	8	8	5	..	8	8	5
Anglo-California Trust Company	5	..	5	..	6	..	6	
Banca Popolare Fugazi	1	2	3	2	1	2	3	2
San Francisco Savings and Loan Society (The San Francisco Bank in 1925)	4	..	4	..	4	..	4	
Italian-American Bank	2	..	2	..	2	..	2	
The French-American Bank	2	..	2	..	2	..	2	
The Yokohama Specie Bank	..	1	1	1	..	1	1	1
Humboldt Bank	1	..	1	..	1	..	1	
Wells-Fargo Bank and Union Trust Company	1	..	1	..	1	..	1	
The Hibernia Savings and Loan Society	..	..	..	..	1	..	1	
Liberty Bank	..	..	..	..	1	..	1	
The American Bank of San Francisco. (The American Bank in 1925	1	..	1	..	1	19	20	9
Totals	61	109	170	84	65	135	200	102

A comparison of the situation in Los Angeles and San Francisco shows that, in 1924, the Los Angeles banks had 214 branches to San Francisco's 170, but 139 of these in the case of Los Angeles were city branches and only 75 out of the city, while the emphasis in the matter of location was the opposite in the case of San Francisco, since the San Francisco banks had only 61 city branches and 109 out of the city. A partial explanation of this difference, as well as of the rapid increase in the number of Los Angeles branches, lies in the boom expansion of Los Angeles in

population since 1920, while San Francisco has changed but little in the same time.

Oakland.—The situation in the other California reserve city may well be referred to. Oakland lies just across the bay from San Francisco, and this proximity to an important financial center undoubtedly tends to lessen the financial importance of Oakland. Only three banks were engaged in branch banking in Oakland in 1924. Late in 1924, the American Bank (Oakland) merged with The American Bank of San Francisco which took the name The American Bank. This transferred the head office from Oakland to San Francisco. The new institution purchased The First National Bank of Oakland.[1] P. E. Bowles had been president of all three of the institutions before the merger. It is apparent that the change, therefore, had little effect on the actual, as distinguished from the nominal, situation. The American Bank still counts itself an "East Bay institution."[2]

The following table shows the situation in Oakland in 1924 and 1925:

Oakland Banks with Branches

Name of Bank	June, 1924				June, 1925			
	Number of branches			Towns	Number of branches			Towns
	Oakland	Other	All		Oakland	Other	All	
The American Bank	4	9	13	8	Head office in San Francisco			
The Oakland Bank	9	..	9	..	9	..	9	
Central Savings Bank of Oakland	1	..	1	..	1	..	1	
Total	14	9	23	8	10	0	10	0

Country Banks.—For the smaller towns and cities of the state it is not feasible to give the names of the banks participating in the movement, since there are so many of them. In the cities of San Diego, Pasadena, Sacramento, Long Beach, and one or two

[1] *Annual Report* of the Superintendent of Banks of California, 1925, p. 714.
[2] Interview with W. H. Taplin of The American Bank, Aug. 20, 1925.

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Italian-American Bank	2	..	2	..	2	..	2	
The French-American Bank	2	..	2	..	2	..	2	
The Yokohama Specie Bank	..	1	1	1	..	1	1	1
Humboldt Bank	1	..	1	..	1	..	1	
Wells-Fargo Bank and Union Trust Company	1	..	1	..	1	..	1	
The Hibernia Savings and Loan Society	..	..	..	..	1	..	1	
Liberty Bank	..	..	..	..	1	..	1	
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Central Savings Bank of Oakland	1	..	1	..	1	..	1	
Total	14	9	23	8	10	0	10	0

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[1] *Annual Report* of the Superintendent of Banks of California, 1925, p. 714.
[2] Interview with W. H. Taplin of The American Bank, Aug. 20, 1925.

smaller places, the banks have branches in the home city of the parent bank. In 1924, there were eighteen such branches, and in 1925, there were twenty-one distributed as follows:

Number of local branches	1924	1925
1	12 banks	10 banks
2	6 banks	4 banks
3	....	3 banks
4	....	4 banks

From this table it is apparent that the system of city branch banking has affected not only the large cities of the state but also some of the smaller places. This development, however, is very limited as compared with the great growth in Los Angeles and the country ramifications of Los Angeles and San Francisco systems.

The following table gives a comparison of the number and size of all the branch-banking systems of the state with head office outside Los Angeles and San Francisco:

BRANCH-BANKING SYSTEMS OUTSIDE LOS ANGELES AND SAN FRANCISCO CLASSIFIED BY NUMBER OF BRANCHES

Year	Number of branches													
	1	2	3	4	5	6	7	8	9	10	11	12	13	Total
1910	19	2	..	..	..	..	..	..	..	..	..	..	..	21
1920	37	19	4	1	1	..		..	..	..	..	..	..	62
1924	36	14	10	1	1	..	..	..	1	..	..	..	1	64
1925	37	11	11	2	..	..	..	1	1	..	..	..	..	63

The nine-branch system listed for 1924 and 1925 was an Oakland bank, with branches entirely confined to the city, as was also the thirteen-branch system listed for 1924, although not all of the branches of the latter were within city limits. The bank

with five branches in 1924 was the Southern Trust and Commerce Bank of San Diego, which acquired three more branches in the following year. The number and size of the country systems changed very little between 1920 and 1924, a decline of one in the one-branch systems, a decline of five in the two-branch systems, and an increase of six in the three-branch systems. The country systems were not an important factor in the growth of branch banking from 1920 to 1924. Nevertheless, their ability to survive and grow in strength in spite of the absorption of country banks by the city systems is noteworthy. Although thirteen branches were removed from the total by the American Bank merger with a San Francisco institution, the number of branches increased from 96 in 1920 to 117 in 1925.

The outstanding characteristics of this period are the astounding rapidity of growth of branch banking in the whole state and the expansion of Los Angeles and San Francisco banks into country territory.

CAUSES OF THE RAPID GROWTH OF BRANCH BANKING IN CALIFORNIA IN THE YEARS 1920–1924

The change from a slow rate of growth, which had characterized the preceding period, to the rapid rate of growth of branch banking in the years 1920 to 1924 requires a special explanation. In a social movement which rests, in part, at least, upon the educative effect of successful examples, it might be expected that the movement would become more rapid as the examples became more widely scattered and, hence, better known. Undoubtedly, this fact had something to do with the greater rapidity of growth in the years following 1920. Such a general explanation, however, of the change in rate of growth of branch banking in California would be incomplete.

Action of Bank of Italy.—The specific explanation of this development lies in three things: First, the upsetting of established relationships through the aggressive action of the Bank of Italy in the acquiring of out-of-town branches by the purchase of independent country banks which had previously been correspondents of various city banks. As the other large city banks joined in the movement, this first factor, the disturbance of the

correspondent relationship, operated with increasing force on all large city banks.

Required Reserves under the Federal Reserve Act.—A second factor which influenced this development was the weakening of the ties of the correspondent relationship by the provisions of the Federal Reserve Act with regard to redeposited reserves. Formerly, a part of the country bank's legal reserve was carried on deposit with its city correspondents in reserve cities. The Federal Reserve Act, as amended June 21, 1917, required every bank belonging to the Federal Reserve System to maintain its entire legal reserve in the form of a deposit at the Federal Reserve Bank of its district.[1] Moreover, the Federal Reserve banks undertook to perform many of the services previously performed by the country banks' city correspondents, such as the collection of out-of-town checks.[2] This factor applied only to members of the Federal Reserve System, but all of the national banks were members, and many of the state banks had joined the system. Since the ties were weakened, it was more difficult to retain the country correspondents, and the activity of competitors who were drawing away country correspondents by converting them into branches became all the more serious.[3]

Los Angeles Boom.—The third factor in explaining the sudden growth of the period applies particularly to the increase in the number of city branches and is the Los Angeles boom which increased the population of Los Angeles very greatly, creating a demand for additional banking facilities and bringing about a condition of traffic congestion which favored the establishment of so-called "service station" branches.

Bankers' Balances.—To show the situation in regard to changes in the correspondent relationship during this period, the following table has been constructed:[4]

[1] Kemmerer, Edwin Walter, "The ABC of the Federal Reserve System," p. 36.

[2] *Ibid.*, p. 67.

[3] MacDonnell, James S., "The Community Bank *vs.* the Branch Bank: An Address," Jan. 23, 1923. Pamphlet.

[4] Compiled from *Reports* of the Comptroller of the Currency, 1920, 1921, 1924, and *Annual Reports* of the Superintendent of Banks of California, 1920, 1921, 1924, *passim.*

BANKERS' BALANCES IN CALIFORNIA RESERVE CITIES, IN THOUSANDS OF DOLLARS

Cities	June 30, 1920		June 30, 1921		June 30, 1924	
	Due to banks	Resources	Due to banks	Resources	Due to banks	Resources
National Banks:						
San Francisco	89,677	452,262	66,529	345,948	58,341	295,714
Los Angeles	26,821	166,302	23,939	174,432	39,082	267,598
Oakland	3,090	28,057	3,289	27,706	3,532	34,305
Totals	119,588	646,621	93,757	548,088	100,955	597,617
Per cent of resources	18.5		17.1		16.9	
State Banks:						
San Francisco	12,684	545,524	17,603	601,552	45,674	1,059,088
Los Angeles	3,989	269,998	3,833	304,135	11,939	603,053
Oakland	614	82,110	513	85,785	645	110,018
Totals	17,287	898,632	21,949	991,472	58,258	1,772,159
Per cent of resources	1.9		2.3		3.3	
Both State and National Banks:						
Reserve cities						
Totals	136,875	1,545,253	114,706	1,539,560	159,213	2,369,776
Per cent of resources	8.8		7.5		6.7	

This table indicates several points very clearly: First, the national banks have much the greater interest in bankers' balances; second, bankers' balances with state banks have increased greatly in absolute terms and considerably in relative terms as compared with their assets; third, the decline in bankers' balances with national banks was sufficient to lower the percentage of such balances in both state and national banks from 8.8 to 6.7 per cent of all resources.

CHAPTER VII

THE BRANCH-BANKING CONTROVERSY IN CALIFORNIA

THE GROWTH OF OPPOSITION

Such a disturbance of established relationships as took place during the period of rapid growth of branch banking, especially in the matter of absorbing country banks into city systems, could not fail to have varying and profound effects upon the different interested parties. As early as 1921, branch banking was recognized as an issue. James S. MacDonnell, president of a Pasadena bank and later vice-president of the California League of Independent Bankers, a bitter opponent of branch banking, quotes an aggressive advocate of branch banking as follows:

> When the Legislature of 1921 therefore adjourned, the situation that confronted us was no longer academic. We faced a condition and not a theory. We are not asked, "Do we like branch banking?" Our problem is, what action shall we take to meet branch-bank development in California?[1]

Public Indifference.—As is usually the case, the directly interested parties have been active in trying to attain their own ends while the public has been relatively indifferent. At any rate, the interests of the public can hardly be stated in sufficiently striking language to make a great popular appeal for either side of the issue, though, just as in the tariff issue, the groups with specific selfish purposes endeavor to appeal to the public through trumped-up concern for public welfare. It can safely be assumed that neither the defendants nor the opponents of branch banking are primarily actuated by a desire to perform an altruistic service for the public.

Interested Parties.—It might well be thought that there were four groups of interested parties in the state: the national banks

[1] MacDonnell, Address, Jan. 23, 1923. (Issued as a pamphlet; pages unnumbered.)

in reserve cities, the state banks in reserve cities, the national banks in the country, and the state banks in the country. This is not the case, however, since the national banks located outside the reserve cities have interests which are almost identical with those of the small-town state banks. To be sure, the latter are permitted to establish branches and, as a matter of fact, have done so, in many cases. These country systems, however, are very small and entirely local in character. The state and the national banks are confronted with the same danger of being absorbed by the large city banks. The fact that the same individual or individuals often operate both a state and a national bank does most to unite the interests of these groups. The characteristic arrangement in California is to operate a state savings bank in conjunction with a national commercial bank.[1]

League of Independent Bankers.—In 1922, these country bankers, state and national, formed an organization, the California League of Independent Bankers, for the purpose of combating the spread of branch banking.[2] The California Bankers' Association was dominated by the large branch bankers who also controlled the extremely important legislative committee of that association.[3] The league, therefore, was needed to give effective expression to the country bankers' desire for restrictive branch-banking laws. It served a further purpose in the encouragement which it gave to the faint-hearted country banker who might otherwise have succumbed to the importunities of the agents of the branch bankers. The league held annual conventions and made recommendations approving or disapproving proposed state or national legislation; the officers of the league were members of the legislative committee of the California Bankers' Association;[4] the league sponsored a monthly publication, *The Independent Banker*, "to meet the demands for information on the branch bank question."[5]

Grounds of Opposition.—It is not easy to sift the mass of objections raised against branch banking and to find the real,

[1] Hearings, April, 1924, Mr. Whipple's testimony, p. 184.
[2] Collins, "The Branch Banking Question," p. 22.
[3] *Cf. The Independent Banker*, March-April, 1925, p. 2.
[4] *The Independent Banker*, March-April, 1925, p. 2.
[5] Ibid., Feb. 1, 1924, vol. I, No. 1, p. 1.

underlying ground of the California country bankers' opposition to it. The investigation is somewhat simplified by asking the question, How might their interests be adversely affected through the conversion of their own or neighboring banks into branches of large city banks? The following answers may be suggested: First, directors and officers of small independent banks are frequently more interested in private business ventures than in the business of their banks. Their connection with an independent bank assures them greater liberality in the matter of credit than they could expect from a branch of a large city bank. Second, many of the small-town bank presidents value very highly the prestige of their positions and object to becoming mere subordinates. Third, there may exist a fear that unfair methods will be employed by the large banks in gaining control of the unit banks. These answers should be tested by the words of members of this group of independent bankers.

Centralization and Loss of Prestige.—In *The Independent Banker*, there are numerous references to the centralization of credit control through the extension of branch banking, and this centralization is uniformly regarded as an evil. Under the heading Banking in England, we find a quotation from an article by Herbert Casson commenting on English conditions:

> Banks are carrying routine too far, say many business men. They are putting safety above all else and are becoming financial bureaucracies. "After all," says one indignant manufacturer, "a bank that will run no risks at all, will soon have no risks to run."[1]

In an article on the McFadden Bill, this statement appears: "The public is more interested in the democratic decentralization of credit control than it is in the progressively concentrative and autocratic control of credit."[2] In another place, under the heading Concentration in California, appears this statement: "The rural centers lose the control of the funds they originate and own more and more as the concentration proceeds."[3] An editorial of the *San Bernardino Sun* is quoted, in which a prediction is made that unless there is a change in California banking theory,

[1] *The Independent Banker*, February, 1924, p. 2.
[2] *Ibid.*, May, 1924, p. 2.
[3] *Ibid.*, Nov. 1, 1924, pp. 2, 3.

within twenty-five years the country customer will be only a numbered account, "a slave lashed to the chariot of metropolitan control."[1] MacDonnell, in his little pamphlet, makes numerous references to the lessened power of the former independent banker and intimates that even the present power accorded to branch managers will be taken away as the branch systems become more firmly entrenched.[2]

Reply.—In this literature, the great emphasis on the concentration of credit control, combined with the references to loss of prestige on the part of individual bankers, indicates that there is some personal advantage to the small-town banker in exercising such control. It is apparent that the main advantage consists in the power to make loans to certain individuals or under certain circumstances which would not meet with the approval of a branch-banking institution being operated for profit as a bank rather than used for the profit of an outside business. The instances in which the lending power of banks has been abused are altogether too numerous. A flagrant case occurred in the early history of banking in San Francisco, referred to above.[3] More recently, the Valley Bank, Fresno, suffered such an experience, which proved disastrous for the stockholders though the depositors were protected from loss through the action of the superintendent of banks in inducing the Bank of Italy and the Pacific-Southwest Trust and Savings Bank to purchase the bank and assume the liability to depositors.[4]

The independent-banker plea for the maintenance of easier credit rests on no sound public basis. The branch banker makes his profit by lending and has therefore as much incentive as is desirable for making liberal loans, but these loans are safer than many independent-bank loans, for the latter are too much subject to the influence of sentiment, if nothing worse.

Use of Unfair Methods of Coercion.—As regards the third possible fundamental reason for opposition to the spread of branch banking, namely, the fear that the stockholder will not

[1] *Ibid.*, June 1, 1924, p. 1.

[2] See note 3, *supra*, p. 66.

[3] *Supra*, p. 32.

[4] *Annual Report* of the Superintendent of Banks of California, 1925, pp. 727–797.

be sufficiently rewarded for making the change, no quotation in the files of *The Independent Banker* could be found to indicate the existence of such a fear, with the exception of one brief article in the August, 1924, number, on Absorption of Unit Banks.[1] At the hearing before the House Committee in 1924, the unit bankers made the charge that coercion had been used by the branch bankers.[2] The coercion complained of, however, if it actually existed, seems to have been directed to compelling a sale of the bank rather than to obtaining it at an unfairly low price. The direct testimony of Mr. Morrish as to the offers made to him indicates a considerable measure of insistence on the part of the branch bankers but does not warrant the assumption that the branch bankers were not willing to pay a fair, even liberal, price for the stock.[3] The absence of definite complaint and well-authenticated testimony seems to indicate that the opposition to the absorption of the unit banks does not arise from a consideration of the stockholders' interests. Indeed, references may be found to show that the stockholders think that they are profiting by the change. MacDonnell says, "Don't take the advice of two or three wheezy stockholders, who get panicky or greedy for what they think will be an immediate profit on their stock."[4]

Reserve-city Banks.—The other two groups of interested parties, the national banks in reserve cities and the state banks in reserve cities, have met the situation not by public opposition to branch banking but by a gradual adoption of that amount of branch banking which each particular bank has deemed profitable and which has been legally permissible for it. Neither of these groups has participated to an important extent in the activities of the California League of Independent Bankers. Only one of the sixteen members of the executive council of the league, in 1925, was connected with a bank located in a reserve city, and the reserve city was Oakland, not Los Angeles or San Francisco.[5]

[1] *The Independent Banker*, August, 1924, p. 2.
[2] Hearings, 1924, pp. 184–186. Whipple's testimony.
[3] Hearings, 1924, pp. 176–177.
[4] MacDonnell, "The Community Bank *vs.* the Branch Bank."
[5] *The Independent Banker*, May-June, 1925, p. 1.

The national bankers in the reserve cities have not been active either in support of or opposition to branch banking. The state bankers in these cities, on the other hand, have been prominent defenders and advocates of branch banking. A delegation of these reserve-city branch bankers appeared in Washington before the House Committee in April, 1924, in an effort to prevent the passage of legislation unfavorable to the further extension of branch banking.[1]

STAGES IN THE CALIFORNIA BRANCH. BANKING CONFLICT

A discussion of the effects of the growing opposition to the spread of branch banking in California falls naturally into two main parts, the state administrative and legislative attempts and the federal attempts. In brief, the state banking department has endeavored to curb certain branch-banking developments through the imposition of the *de novo* rule; the Bank of Italy has contested this rule both in the courts and in the legislative halls, while the opponents of branch banking have also sought legislative relief. The federal activities have been of three sorts, establishment of tellers' windows under the authority of the Comptroller of the Currency by national banks, imposition of a restrictive ruling by the Federal Reserve Board, and agitation for the passage of a national act legalizing city branches of national banks where state banks are permitted to have branches and prohibiting out-of-the-city branches, even to state members of the Federal Reserve System, except such branches as might be already in operation at the time of passage of the act.

THE DE NOVO RULE

Section 9 of the Bank Act, which states that no bank may establish a branch without the written approval of the superintendent of banks, which "may be given or withheld in his discretion," lays down no criteria by which the superintendent is called upon to judge whether "the public convenience and advantage will be promoted by the opening of such branch office."[2] In the earlier years, the interpretation of this section

[1] Hearings 1924, *passim*, p. 54, *cf. supra*, p. 36.

[2] California Bank Act, 1925, Sec. 9, *cf. supra*, p. 38.

apparently furnished little difficulty. Local branches were freely permitted, and more distant branches were usually the result of taking over independent banks.[1]

Presumably as a result of the sudden growth of branch banking in 1920 and 1921, with the springing up of several competing branch-bank systems, the superintendent of banks, Jonathan S. Dodge, in November, 1921, promulgated the so-called "*de novo* rule."[2] This rule was stated as follows:

> No branch of any bank shall be created in any locality other than the city or locality in which is located the principal place of business of such bank except by purchase of, or consolidation or merger with an existing bank in such city or locality in which it is desired to create or establish such branch bank unless the superintendent of banks in his discretion shall find that the public convenience and advantage require it.[3]

While the previous practice had, in the main, at least, been in conformity with this rule, still, this appears to have been the result of a lack of desire on the part of the banks to establish *de novo* branches outside the city, rather than of any restrictions imposed by the superintendent of banks.[4] On the surface, this rule appears to be very suitably drawn up to prevent the establishment of an excessive number of out-of-the-city branches in small communities. The rule stated in a positive form would indicate that the superintendent intended to accept as evidence of public convenience and advantage the previous existence of the branch as an independent bank and would leave unexpressed other criteria that might be used in judging of public convenience and advantage. The negative form, however, and the use of the word "require" instead of "will be promoted" clearly indicate that the superintendent looked upon the rule as restrictive rather than as permissive; that is, while the department will readily accept requests and grant permits for branches by purchase, it

[1] Petition for Writ of Mandate, S. F. 11, 654, in the Supreme Court of the State of California, p. 14.

[2] *Ibid.*, p. 22.

[3] *Ibid.*, pp. 22–23.

[4] But *cf. The Independent Banker*, January-February, 1926, p. 2: "It has been the rule for over ten years with the past Superintendents of Banks that no *de novo* branches would be authorized except . . ." etc.

will be difficult for a bank to prove that a *de novo* branch is *required.*

Opposition to De Novo Rule.—While this rule has disadvantages from the public point of view, in that it tends to discourage, if not actually to prevent, the establishment of small branches in country communities which are too small to support an independent-banking institution, still, it is not from this that opposition has arisen to the ruling. The opposition has come from a desire on the part of the Bank of Italy to establish branches in Los Angeles. In the small towns, it appears, there are a sufficient number of banks which may be bought and converted into branches, so that the imposition of the rule means no great hardship for the branch-banking systems. In the two large cities of the state, however, the number of independent banks is very small, both because of the high capital requirements, and, now, because of the large number of city branches. For this reason, a bank located in one of these large cities and wishing to establish branches in the other has a very restricted field of operations unless it is allowed to establish *de novo* branches. On the other hand, the banks located in each of the cities are permitted freely to establish branches within the city in which the parent bank is located. As a rule, the banks in the two cities appear to have been willing to confine their activities to the northern or southern part of the state, depending upon the location of the parent bank. There were two unimportant and one important exceptions to this rule. The Yokohama Specie Bank had one branch in Los Angeles, and the Banca Popolare Fugazi had a branch in Santa Barbara.[1] The important exception was the Bank of Italy, which had six branches in Los Angeles[2] as well as several others in the southern part of the state.[3] In spite of its desire to establish other branches in Los Angeles, since 1921 the Bank of Italy had refrained from making application for permits to establish branches *de novo* in Los Angeles, except two, to be referred to later,

[1] *Supra,* p. 55.

[2] Petition for Writ of Mandate, S. F. 11, 654 in the Supreme Court of the State of California, Bank of Italy *vs.* John Franklin Johnson, p. 12. (In subsequent references, the title of this report is abbreviated to *Bank of Italy Petition.*)

[3] *Ibid.,* p. 11.

. . . because petitioner believed that such applications would be so denied by the incumbent Superintendent of the State Banking Department for the reason embodied in the *de novo* rule but in terms on the ground that the public convenience and advantage would not be promoted by the establishment of such branches (without mention of said *de novo* rule), thereby putting upon your petitioner the burden of attacking the determinations of the incumbent Superintendent of the State Banking Department as involving abuses of discretion and arbitrary exercises of power, an issue in which your petitioner, with full faith in its rights and the merits of its desired applications, was disinclined to embroil itself until longer forbearance should become intolerable.[1]

Attempt to Get New Legislation.—By the end of 1924, the Bank of Italy appears to have decided that further "forbearance" was unnecessary if not "intolerable." The first action came not directly from the Bank of Italy but from the officer of a closely affiliated institution, and the subsequent development indicates that he was acting in substantial harmony with Bank of Italy wishes. Orra E. Monnette, president of the Bank of America in Los Angeles, claiming to represent only the Bank of America and his own personal views, appeared, in January, 1925, before the Legislative Committee of the California Bankers' Association to present a measure which he proposed to have introduced in the state legislature with or without the approval of the committee and, failing of action there, to have submitted on the ballot as an initiative measure.[2] He charged that the superintendent of banks was discriminating against his bank in denying applications for branches. The bill which he submitted to the committee for its consideration was later introduced in the lower house as "A. B. 332" by Assemblyman Carter.[3] This bill was designed to compel the superintendent of banks to hold a public hearing on requests for permits to establish branches and provided, further, that

If it shall appear from the evidence upon such hearing, or, in the event a public hearing shall not be held, if it shall appear from the examination of the application by the Superintendent of Banks or from

[1] *Ibid.*, pp. 27–28.

[2] *The Independent Banker*, March-April, 1925, "The Bank of Italy Goes to the Legislature," p. 2.

[3] *Ibid.*, p. 3.

such examination and any additional investigation made by him that the public convenience and advantage will not be promoted by the opening and maintaining of such proposed branch by the applicant he shall deny the application and refuse the certificate; otherwise, he shall issue his certificate authorizing the applicant to open such branch in accordance with its application.[1]

The obvious purpose of this bill was to limit the discretionary power of the superintendent. How effective it would have been in accomplishing this purpose it is not necessary to inquire, since the proposal was withdrawn and replaced by another of a more definite character.

When the Legislative Committee met on Mar. 3, 1925, Mr. Monnette informed them that the Carter Bill would be replaced by Assembly Bill 1,086 introduced by Spaulding and Wright. This bill was known as the "Bank of Italy Bill" and was presented to the Legislative Committee by Mr. Williams, who was a member of that committee and a representative of the Bank of Italy.[1] On question by the Committee, he admitted that it was the purpose of the Bank of Italy to have the bill enacted by the legislature and, failing that, to submit it to the initiative.[1] This bill was considerably different from the Carter Bill and proposed to restrict the superintendent's power over the establishment of branches even more effectively than the former proposal would have done. The new bill provided that, if 20 per cent of the voters of a

. . . given geographical area in any community containing at least five hundred voters shall petition the Superintendent of Banks that he grant a permit to establish a branch office to a qualified bank making such application, within twenty days he must verify the petition and within forty days he must grant his written approval to the opening of the branch.[1]

Williams was the only member of the committee in favor of the bill. This meant that Sartori, Chaffey, and Davidson, who represent large branch-banking systems, joined with the repre-

[1] *Ibid.*

sentatives of the unit bankers in opposition to the proposed measure.[1]

A few days later, Mar. 12, 1925, Mr. Williams presented an amended bill to the committee.[2] The amendment was intended to limit the operation of the bill to Los Angeles and San Francisco. It further altered the original bill by substituting the requirement that the petition must be signed by 200 voters in place of the previous proposed requirement that the petition be signed by 20 per cent of the voters of the particular geographical area of the community in question. Even with this modification of the bill, which was clearly intended to remove some of the opposition of the country bankers, at least, the bill found no favor with the Legislative Committee, and again Mr. Williams cast the only vote in favor of recommending the bill to the legislature.[2]

On Mar. 17, the Assembly Committee on Banking held hearings on the amended bill. No one appeared before the committee in favor of the bill except direct Bank of Italy representatives and Mr. Monnette of the affiliated Bank of America.[3] Among those who were present to oppose the bill were several leading branch bankers as well as the representatives of the independent bankers.[3] On Mar. 24, 1925, the bill was tabled by the Assembly.[4] So ended, for the time at least, the Bank of Italy's first decisive effort to overthrow the *de novo* rule.

Earlier Compromise.—To understand the situation in which the Bank of Italy stood opposed to the other branch bankers of California and to have a basis for the understanding of the next step taken by the Bank of Italy, it is necessary to turn back to an event which occurred early in 1923. This event was a compromise between certain of the branch bankers and the unit bankers.

While the *de novo* rule had been formally promulgated in 1921, it did not fully meet the desires of those who were opposed to the practice of intercommunity branch banking. The California League of Independent Bankers was active in its attempts to bring about decisive legislation dealing with the question. Two

[1] *Ibid.*, pp. 3–4.
[2] *Ibid.*, p. 4.
[3] *Ibid.*
[4] *Ibid.*, p. 2.

bills were introduced in the California legislature in January, 1923. One of these, the Kline Bill, was sponsored by those who sought to abolish intercommunity branch banking. The other, the Baker Bill, was favored by those who wished merely to equalize competition between branch and unit banks.[1]

The Legislative Committee of the California Bankers' Association acting as a special committee on branch banking was unable to arrive at an agreement on the proposed legislation.[2] On Mar. 7, 1923, a meeting of representatives of the League of Independent Bankers and of the Legislative Committee took place in the presence of the superintendent of banks and his attorney, and an agreement was reached.[3] The agreement constituted an acceptance of the proposal of the superintendent that two amendments to the Bank Act be recommended and that the Banking Department issue three rulings. The two amendments, which were subsequently enacted into law, deal with the requiring of the separate report of branch-bank deposits for each city where branches are operated and the publication of these reports.[4] The three rulings were far more important and were, in essence, amplifications of or extensions of the *de novo* rule. In view of the importance of these rules, they may well be quoted in full:[5]

Banks Must Be Three Years Old, Etc.—From and after this date, no branch office shall be established by any bank in a city or locality other than that in which its principal place of business is located by the purchase of or consolidation or merger with another bank unless both banks shall have been open for business for at least three years prior to said sale, consolidation or merger, unless the Superintendent of Banks in his discretion shall find that the public convenience and advantage require it; in the case of a National bank that has been converted into a State bank, the time required herein shall be considered as running from the date of the original organization of said National bank.

One Branch in City Other than That of Parent Office.—From and after this date, no more than one branch office shall be established by any

[1] *Ibid.*, p. 6.

[2] *Ibid.*

[3] *Ibid.*, p. 7.

[4] *The Independent Banker*, March-April, 1925, p. 9, California Bank Act, 1923, Secs. 130, 132*a*.

[5] *The Independent Banker*, March-April, 1925, pp. 9–10.

bank in a city or locality other than that in which its principal place of business is located, unless the Superintendent of Banks in his discretion shall find that the public convenience and advantage require it. In the event, however, of sale, consolidation or merger, all branches that have been maintained for a period of three years prior to such sale, consolidation or merger by the respective institutions or banks concerned may be thereafter continued as branches of the consolidated banks. The three-year requirement herein provided shall not be construed as applying to branch offices in existence as of this date.

Forbidding De Novo Branches.—From and after this date, no branch shall be created in any locality other than the city or locality in which is located the principal place of business except by purchase of or consolidation or merger with an existing bank in said city or locality unless the Superintendent of Banks in his discretion shall find that the public convenience and advantage require it.

The first of these rules was designed to prevent a fairly obvious evasion of the spirit of the *de novo* rule through the establishment of nominally independent banks merely for the purpose of taking them over as branches. The second rule introduced an entirely new principle for the limitation of intercommunity branch banking. While it might well be argued that the previous existence of a branch as an independent institution was the strongest proof of the "public convenience and advantage" of the branch, no such argument can be adduced in support of the rule limiting the number of out-of-town branches to one per town or city, regardless of the size of the city involved. This is, on the face of it, purely designed to limit the number of such branches without a consideration of public convenience and advantage, for, surely if one branch is convenient and advantageous to the public in a town of 200 people, several such branches might well be convenient and advantageous in a city of 1,000,000 people. It is claimed that this rule was adopted or established "for the purpose of preventing a monopoly in California on the part of any branch-banking organization" through flooding out all other institutions by a pernicious duplication of branches.[1] Regardless of the motive for the rule, there can be no question as to its effect in checking the spread of intercommunity branch banking, especially as between the larger cities.

[1] *The Independent Banker*, March-April, 1925, p. 6

The Appeal to the Supreme Court.—The other branch banks appear to have been willing to abide by the compromise represented by these rules, but the Bank of Italy not only undertook the legislative program referred to above[1] but also attacked the *de novo* rule directly through the California Supreme Court. Shortly after the failure of the legislative attempt, the Bank of Italy filed with the Supreme Court of California a petition for a writ of mandate which would direct the superintendent of banks to give his written approval for the opening and maintaining of two branch offices in the city of Los Angeles, permission for which had been previously denied.[2] The Bank of Italy expected to test the validity of the *de novo* rule by this action, since it was the contention of the Bank of Italy that the superintendent of banks based his refusal of the desired permit solely on that part of the *de novo* rule which refers to the establishment of *de novo* branches only through the purchase of an already established bank.[3] The Bank of Italy contended that this basis of refusal did not take into account "public convenience and advantage" which were the only criteria established by the law. The Bank of Italy, therefore, held that the questions of law involved in the case were: (*a*) the meaning of the provision in Section 9 of the Bank Act, relating to establishment of branches; and (*b*) the validity and construction of the *de novo* rule.[4] The brief on "Points and Authorities" continued:

> We shall submit that the *de novo* rule is invalid (*a*) because contrary to the plain implications of section 9 of the Bank Act; (*b*) because there is no statutory provision authorizing the promulgation by the superintendent of banks of such a regulation; and (*c*) if there had been, the statute would have been invalid as involving unconstitutional delegation of legislative power.[5]

Not only did the Bank of Italy look upon this case as a means of testing the validity of the *de novo* rule, but the California League

[1] *Supra*, pp. 76–78.

[2] Bank of Italy Petition, p. 35

[3] Bank of Italy Petition, pp. 24, 25, 32, 33.

[4] S. F. 11,654, in the Supreme Court of the State of California, Bank of Italy *vs.* John Franklin Johnson, Points and Authorities of Petitioner upon Application for Alternative Writ of Mandate, p. 7.

[5] *Ibid.*

of Independent Bankers took the same view of the matter and employed counsel to appear as *amici curiae* in support of the superintendent of banks.[1] The reply of the superintendent of banks, however, indicated that the issue might not be definitely met. The original petition of the Bank of Italy had been filed on June 18, 1925, and an alternative writ of mandate had been issued June 22, 1925, returnable before the Court at Los Angeles, Sept. 15, 1925.[2] The answer filed by the superintendent of banks was voluminous,[3] and in it he claimed, first, that the *de novo* rule was merely to assist him in passing upon applications and that it specifically provided for the exercise of his discretion on the question whether or not public convenience and advantage required the opening of any proposed branch and, second, that Los Angeles as a community was already sufficiently supplied with banks and banking facilities, if not oversupplied.[4]

From the nature of the superintendent's reply, there arose a possibility that the court might simply refuse the writ of mandate on the ground that public convenience and advantage would not be promoted by the establishment of the two new branches sought, thus leaving the validity of the *de novo* rule still undecided. Fortunately, however, the court did not thus side step the main issue, even though subsequent pleading introduced still other suggested justification of the superintendent's refusal of the desired permits.

In the oral argument of the case, on Apr. 9 and 10, 1926, a new issue was injected into the controversy when the superintendent of banks, through Mr. Oliver, attorney for the department, charged that the Bank of Italy was assuming the proportions of a banking monopoly and that if no restrictions were placed on indiscriminate issuance of permits for branch banks *de novo*, independent banking in California would be wiped out.[5] Mr. Cullinan, attorney for the Bank of Italy, pointed out that Mr. Oliver had asserted before the Congressional Banking Committee

[1] *The Independent Banker*, August-September, 1925, p. 2.

[2] Bank of Italy Petition, p. 1, note.

[3] Taylor, B. Grant, letter to the author, Mar. 30, 1926, clerk's office, Supreme Court of California; 75 pp. in the answer.

[4] *The Independent Banker*, August-September, 1925, pp. 1–2. A summary of the superintendent's answer is given on these pages.

[5] *The Independent Banker*, March-April, 1926, p. 10.

at Washington that branch banking was not and could not become monopolistic and that therefore the position "which counsel took before the Court in asserting that the Bank of Italy was fast approaching a monopoly was untenable."[1]

In response to this contention of Mr. Cullinan, an "addendum to brief for respondent" was filed by Mr. Oliver in which it was claimed that while branch banking would not lead to monopoly, the Bank of Italy was part of a system of chain banking that would lead to monopoly and "has all but arrived at that point."[2] Mr. Oliver further indicated some of the difficulties from an administrative official's point of view in attempting to control chain banking. In the case of the Bank of Italy group, some of the banks were in the national system and some were in the state system, while the Bancitaly Corporation, the Americommercial Corporation and the Stockholders' Auxiliary Corporation, holding companies, were not banks at all and therefore not subject to supervision of the banking authorities.

> Bad paper and securities or dangerous or vicious practices ferreted out in banks in one system are easily transferred to banks in the other system, because all the banks in the chain are governed through one head. Such indeed has been the practice in the State of California in certain chain banking systems other than petitioner.[3]

The public suffers in case of failure, for

> . . . the rotten assets acquired in the unfortunate ventures are shifted into one particular link or unit of the chain system in which the interest of the persons controlling the chain may perhaps be comparatively small.

These evils are characteristic of chain banking and not of branch banking, since a branch bank is necessarily entirely in one system, state or national, and is furthermore a unit so that it is impossible to injure one of the branches without injuring the whole system.[4]

The closing paragraph of the brief is very significant.

> The Bank of Italy, the Liberty Bank, or any other one of the branch banks belonging to this chain, in and of themselves are legitimate, and

[1] *The Independent Banker*, May-June, 1926, p. 1.

[2] *Ibid.*, p. 4.

[3] *The Independent Banker*, May-June, 1926, p. 31.

[4] *Ibid.*, p. 2.

by themselves, without being externally controlled and dominated from one brain and one organization, could be completely and satisfactorily regulated in the interests of the depositing public and of the state by the Banking Department of the State of California, but the chain banking system of the Bancitaly Corporation cannot be reached for these purposes. The only recourse left open to that Department, if it is to do its duty and serve the public, in so far as yet remains possible, is to halt the growth of the various members of that system, each legitimate in itself, but whose operation as parts of a chain banking system is opposed to public policy and public convenience and advantage and in its very nature a menace to the people of the State of California. Not only is this huge system monopolistic in its tendency, but the desperation with which it has sought to break down the power of the State Banking Department, as evidenced by this proceeding itself, its mushroom growth, the extraordinary prices it is willing to pay for banks to add to its chain, and the great lengths to which it will go by indirect methods to acquire new banks, all demonstrate that its tendencies for monopoly have not been neglected, but have been and are being used with effectiveness, and we desire here and now to point out to this Court that the attempt in this proceeding to attack the power of the Superintendent of Banks under section 9 of the Bank Act is the opening gun of the final attempt upon the part of this huge octopus to irrevocably fix for all time its monopolistic tentacles upon the banking resources of the State of California.[1]

De Novo Rule Upheld by the Court.—The Supreme Court of California finally rendered its decision in the case on Dec. 15, 1926. The court upheld the legality of Section 9 of the Bank Act and held that the *de novo* rule on the face thereof was a

. . . lawful exercise of the powers of the superintendent of banks as a policy to be followed by him and as an indication to applicants for branch bank permits of the showing necessary to be made to entitle them to obtain affirmative action on their applications, but in no sense as restricting, modifying, or controlling his statutory discretion.

The court further held that while the original reasons given by the superintendent for denying the requested permits were insufficient, the evidence was strong enough to support the superintendent's conclusion that public convenience and advantage would not be promoted by the opening of said branch banks and therefore refused to grant the peremptory writ sought by

[1] Quoted in *The Independent Banker*, May-June, 1926, p. 4.

the Bank of Italy.[1] The court held that it could not properly substitute its discretion for that of the superintendent when the evidence was sufficient to support a conclusion either way.[2]

The court commented upon the difficulty or, indeed, impossibility of giving a final definition of the expression "public convenience and advantage." While the court was inclined to the view that

> . . . the interest of the public immediately contiguous to the proposed branch bank or of the public reasonably subject to service by the proposed bank should first be considered by the superintendent of banks . . .

they were not prepared to hold that

> . . . the superintendent of banks may not in the administration of the duties imposed upon him take into consideration the question whether the convenience and advantage of the people of the entire state would be promoted or retarded by the unlimited establishment of state-wide branch banks.[3]

Since this reasoning did not influence the decision in this particular case, it must be treated as *obiter dicta;* nevertheless, it is important as foreshadowing the outcome of any future case in which a permit may be denied on the grounds of general policy rather than because of the sufficiency of local banking facilities.

In view of the emphasis of the court upon the discretionary power of the superintendent of banks, it is clear that the future development of branch banking in California depends very largely upon the way in which that official exercises his discretion.[4] The *de novo* rule may no longer be accepted as the final determinant, in any case. The superintendent must not refuse to use his statutory discretion, but his statutory discretion may always arrive at the same result as if he had used the *de novo* rule alone whenever reasonable evidence may be introduced to show the lack of "public convenience and advantage" in the proposed branch establishment.

[1] *The Independent Banker,* November–December, 1926, pp. 5–23, Complete text of the Supreme Court decision in this case. *Cf.*, especially, p. 23.

[2] *Ibid.*, p. 20.

[3] *Ibid.*, p. 12.

[4] For the immediate development in early 1927, see pp. 161–162, *infra.*

CHAPTER VIII

THE BASIS OF NATIONAL INTEREST IN THE CALIFORNIA BRANCH-BANKING DEVELOPMENT

THE NATIONAL BANK QUESTION IN CALIFORNIA

Private Banks.—At the time of the passage of the original National Bank Act in 1863, the business of banking was carried on almost exclusively by private rather than incorporated banks.[1] There was only one incorporated bank in San Francisco in 1863, although Wells Fargo and Company, incorporated under the laws of Colorado, was doing a banking business there, as were also two branches of British-American banks, which were incorporated by royal charter.[2] Banking in California did not involve the issue of bank notes. The state constitution adopted in 1850 had given expression to the Western preference for "hard money" in the following section:[3]

> The legislature shall have no power to pass any act granting any charter for banking purposes, but corporations or associations may be formed for such purposes under general laws. No corporation, association, or individual shall issue or put in circulation, as money, anything but the lawful money of the United States.

Effect of "Hard-money" Preference.—During the Civil War, the great issues of United States notes by the federal government had put the country on a paper standard. Popular sentiment in California, however, was so strongly opposed to the use of paper money that gold continued as the circulating medium in that state while the rest of the country used government paper money which was not restored to a gold basis until 1879.[4] This

[1] Wright, "Banking in California, 1849–1910," p. 47.

[2] *Ibid.*

[3] Constitution of the State of California, Art. XII, Sec. 5. *Cf.* also the Political Code, Sec. 356.

[4] Knox, "A History of Banking in the United States," p. 845.

popular sentiment had the effect of retarding the organization of national banks in California. Out of deference to this feeling, Congress, on July 12, 1870, passed an act which permitted the organization of national gold banks, that is, banks the currency of which should be redeemable on demand in gold instead of the depreciated government paper money then in circulation.[1] Only nine of these gold banks were organized.[2] The fact that this act was passed and that even nine such banks were organized in California even though the circulation was limited to 80 per cent of the par value instead of 90 per cent as was the case with the other national banks shows the force of this sentiment in controlling banking development. This sentiment did not disappear even after the resumption of specie payments in 1879,[3] and, as a consequence, national banks did not increase rapidly, since every national bank was compelled to buy low-yield government bonds to secure circulation whether the circulation was actually used or not.[4]

Growth of National Banks after 1900.—With the liberalization of the National Bank Act in 1900 and with a weakening of the opposition to bank notes as the Civil War period faded from the memory of Californians, national banks began to increase in number and in proportion to the number of state banks. This gain continued from 1900 until 1920. At the earlier date, there were 248 state banks with resources of $323,000,000, while there were only 38 national banks with combined resources of $64,000,000. By 1919, the resources were almost equal, standing at $1,132,000,000 for the state banks and at $1,006,000,000 for the national banks. In 1920, the peak was reached in number of national banks and in resources, there being 305 national banks and $1,093,000,000 of resources. The state banks, however, had increased even more rapidly in strength, having resources of $1,402,000,000 by 1920. From 1920 to 1924, the numbers of both state and national banks declined (in fact, the number of state banks had been declining since 1914), but the resources of the state banks were almost doubled in this time, while

[1] *Ibid.*
[2] *Ibid.*, p. 846.
[3] *Ibid.*, p. 845.
[4] 13 Stat. L., p. 104.

those of the national banks remained nearly constant at a billion dollars.

NUMBER AND RESOURCES OF STATE AND NATIONAL BANKS IN CALIFORNIA, 1900–1925[1]

Year	Number of banks		Resources in millions		Year	Number of banks		Resources in millions	
	State	National	State	National		State	National	State	National
1900	248	38	$323	$ 64	1913	468	255	$ 706	$ 490
1901	254	44	354	77	1914	473	262	745	509
1902	269	49	405	92	1915	468	266	764	536
1903	292	61	447	122	1916	460	263	818	646
1904	346	75	472	135	1917	448	270	929	752
1905	404	95	515	182	1918	430	273	1,022	813
1906	449	115	604	254	1919	425	284	1,132	1,006
1907	478	128	623	261	1920	420	305	1,402	1,093
1908	487	143	539	263	1921	423	305	1,496	954
1909	456	159	575	312	1922	429	281	1,658	986
1910	455	187	568	407	1923	429	271	1,985	1,035
1911	452	204	609	442	1924	410	266	2,229	996
1912	455	231	667	500	1925	394	268	2,456	1,006

[1] *Annual Reports* of the Superintendent of Banks of California; *Reports* of the Comptroller of the Currency. Compiled. The figures for state banks are for dates about June 30 of each year, while those for national banks are for dates near Oct. 1. The figures of number of state banks do not include number of branches. The figures for the years 1900 to 1910 are, therefore, arrived at by subtracting the estimated number of branches from the total of banks and branches as given by the reports. The later figures are given exactly by the reports.

Attempts to Make State Incorporation Attractive.—Before 1919, conversions of state banks into national institutions were common. In his 1912 report, the superintendent of banks commented on the conversion, during the year, of nine state banks into national banks.

No particular significance attaches to the nationalization of these banks other than that involved in a desire to appeal to Eastern people in certain localities of the State and because of the lessening of the stockholders' liability in the national system.[1]

Even as late as 1919, a fear of national gains is expressed by the superintendent of banks.

[1] *Op. cit.*, p. 6.

As a practical proposition, we must recognize the growing competition between the national banks and the state banks. If we are to maintain the integrity of the state system, we must meet the situation as it develops, progressively, sanely, and safely.[1]

This fear found expression in legislation designed to improve the competitive position of the state banks. Amendments to the Bank Act, effective July 22, 1919, permitted state commercial banks in cities of not over 5,000 population to act as agents of life, fire, or other insurance companies; removed the requirement of increase of capital on account of certain secured government deposits; and enlarged the power of state banks to rediscount with the Federal Reserve Bank; all for the purpose of placing banks in the state system on a "parity of indulgence" with the competing national banks.[2]

Even after the changes made in 1919, the superintendent was not satisfied but, in the 1920 report, makes several references to the necessity of making the state bank "at least an equal competitor with the national bank."[3] He suggests an amendment to the Bank Act to remove certain hindrances to the use of bankers' acceptances.[4] He continues:

The statute which governs the functioning of our commercial banks is now archaic because of the new and modern implements of finance introduced by the federal reserve system. National banks in California have consequently an advantage over state commercial banks and it is my purpose to equalize this difference.[5]

Movement Away from National System.—A rapid movement away from the national system started in 1920. The assets of the state system were increased by about $45,000,000 by defections from the national system[6] and, in the following year, by $56,000,000.[7] The earlier report suggested as the reason the liberalization of the California Bank Act and the fact that the benefits of membership in the Federal Reserve System were now

[1] *Annual Report,* 1919, p. 15.
[2] *Annual Report,* 1919, pp. 15–17.
[3] *Annual Report,* 1920, p. 11.
[4] *Annual Report,* 1920, p. 18.
[5] *Annual Report,* 1920, p. 36.
[6] *Annual Report,* 1920, p. 15.
[7] *Annual Report,* 1921, p. 24.

available for state banks.[1] The report for the following year was more specific in attributing the popularity of state incorporation to the advantages of departmentalized banking and the privileges and spread of branch banking,[2] and, again in this report, the practical equality in privileges of state and national members of the Federal Reserve System is commented upon.[3]

As shown in the table of state and national bank resources, the absolute decline in national bank resources from 1920 to 1924 was slight, from $1,093,000,000 to $996,000,000. The decline in number of banks was more marked, 305 to 266. The significant fact, however, is the comparative loss of ground by the national institutions, for, during this same period, the state banks' resources jumped from $1,402,000,000 to $2,309,000,000. Their gain was almost equal to the total resources of the national banks. During the same time, the number of state banks also declined, from 420 to 407, but the number of branches had increased from 167 to 516. It is true that national banks also had established 24 or more so-called "tellers' windows," chiefly in Los Angeles.[4]

Caused by Branch Banking.—That this decline in the importance of national banks was due almost solely to the spread of branch banking is revealed by an examination of the history of conversions and incorporations during this period. From Jan. 1, 1919, to Apr. 1, 1924, according to the figures of the Comptroller of the Currency, eighty-six national banks were organized in California and, of this number, twenty were conversions from state institutions, consisting of eighteen banks and two branches.[5] The continuance of conversions into national institutions indicates the popularity of the national banking laws for commercial banking. On the other hand, of the ninety national banks discontinuing business in the state, only four were converted directly into state banks, and two were absorbed by unit state banks, while sixty-seven were absorbed by state banks and operated as branches or consolidated with previously existing

[1] *Annual Report*, 1920, p. 13.
[2] *Annual Report*, 1921, p. 24.
[3] *Annual Report*, 1921, p. 25.
[4] Hearings, 1924, p. 36.
[5] *Ibid.*, Comptroller of the Currency's tables, pp. 43–44.

branches. Eleven were consolidated with other national banks, and six were liquidated and closed out.[1]

Branch-banking Absorption.—Branch banking has affected the decline in number of national banks through the absorption of small national banks to become branches of large-city state banks and not through the defection of the large national banks in order to obtain the privilege of establishing branches under the state law. Only five of the banks which left the national system during this period had capital and surplus of $1,000,000 or over, and only one of these can be said to have been interested in undertaking a branch-banking program. The American National Bank, capital and surplus $2,400,000, became the American Bank of San Francisco in 1923 and later, through consolidation with the American Bank (Oakland) and the First National Bank of Oakland, became the head of a branch-banking system. The only other large bank which converted directly into a state institution was the Wells Fargo Nevada National Bank, which became the Wells Fargo Bank and Union Trust Company. This bank left the national system, Dec. 13, 1923, reducing the resources of that system by many millions. This was, by far, the largest defection from the national system and had nothing to do with the branch-banking privileges of state banks, since the Wells Fargo Bank and Union Trust Company does not care to establish branches. It prefers the correspondent relationship,[2] and the only branch which it has is the Union Trust office in San Francisco. The bank had nearly $146,000,000 of resources on June 30, 1925, not including some $24,000,000 of court trusts. It had about $19,000,000 of bankers' balances at that date.[3] Mr. Drum, testifying before the House Committee, stated that the Wells Fargo Bank went out of the national system to get continuity of trust powers.[4] This statement is borne out both by the large amount of trust business conducted by the bank and by the failure of the bank to establish branches, other than the former office of the Union Trust Company.

[1] *Ibid.*

[2] Hearings, pp. 92, 93.

[3] *Annual Report* of the Superintendent of Banks of California, 1925, pp. 418–419.

[4] Hearings, p. 93.

It is clear that the national banks of California have not felt any overwhelming necessity for branches outside the home city. The demand for city branches, moreover, has not been very great, if one can judge by the number of "tellers' windows" actually authorized. No national banks in San Francisco had tellers' windows or additional offices, on Apr. 1, 1924, and there were only seventeen of these tellers' windows in Los Angeles operated by four different national banks.[1]

STATE BANKS AND THE FEDERAL RESERVE SYSTEM IN CALIFORNIA

The relation of banks in California to the Federal Reserve System is of particular significance, because it is through that system that attempts are being made to curtail the expansion of branch banking. Even before the passage of the Federal Reserve Act, the California legislature took a favorable view of state bank membership in the proposed system, and Section 56 of the Act of 1913 provided, in necessarily general terms, that the state banks might become members of and purchase stock in the proposed national reserve system.[2]

Legislative Permission.—The grant of power under the Act of 1913 appeared to the legislature somewhat too broad, and in 1915 an amendment was added which limited the banks to the exercise of powers "not in conflict with the laws of this state."[3] The matter of reserve requirements also received some attention. The following clause was added to Section 20:

> If any bank shall become a member of a federal reserve bank, it may maintain as reserves on deposit with such federal reserve bank such portion of its total reserves as shall be required of members of such federal reserve bank.[4]

This meant that the member state bank would have to keep the full reserve as required by state law, regardless of any lowering of reserve requirements by the Federal Reserve Act and its amendments.

The state banks did not flock into the Federal Reserve System. In fact, none at all entered the system directly before 1918,

[1] *Ibid.*, p. 36, tables of the Comptroller of the Currency.

[2] California Bank Act, 1913, Sec. 56.

[3] California Bank Act, 1915, Sec. 56.

[4] California Bank Act, 1915, Sec. 20.

and only four in that year, though some state banks had entered the system through the indirect method of conversion into national banks[1] which carried with it the privileges and duties of Federal Reserve membership. The slowness of the state banks in coming into the system was due to two causes. The first was that the state banks were, in the main, savings banks and had little to gain from Federal Reserve membership.[2] The second was that both the state and federal law needed amendment to make membership attractive to state banks. As the matter stood at that time, it seemed preferable for a state bank which desired membership in the system to convert into a national bank and thus to have only one master instead of two who were in disagreement. California was not a great exception in this matter, since, up to June 21, 1917, only fifty-three state banks and trust companies in the whole United States had become members of the system.[3]

Federal Amendment, 1917.—Section 9 of the Federal Reserve Act was amended June 21, 1917, to provide that any state bank becoming a member of the Federal Reserve System should retain its full charter or statutory rights as a state bank or trust company.[4] This was interpreted by the Attorney General of the United States as going so far as to release state bank members from the restrictions of Section 8 of the Clayton Act, which relates to joint directorships.[5] This change in the federal law was not sufficient to attract many California banks into the system in the face of the disadvantages resulting under the unamended state law. The four banks which did come in were relatively small and were located in small cities or towns.[6]

Federal Efforts.—The Federal Reserve authorities made great efforts to get the California banks to come into the system. A committee of the large banks went to Washington to confer with the Federal Reserve Board, and this committee made a promise to do all that it could to add to the strength of the system.

[1] *Annual Reports* of the Superintendent of Banks of California, 1913, p. 6; 1914, p. 11.

[2] Hearings, pp. 84–85, *passim*.

[3] *Annual Report* of the Federal Reserve Board, 1918, p. 25.

[4] *Ibid.*, p. 24. For text of the amendment, see 1917 *Report*, pp. 178–179.

[5] *Annual Report* of the Federal Reserve Board, 1918, pp. 24–25

[6] *Ibid.*, p. 232.

Although the governor of the state refused to call an extra session of the legislature to consider the needed changes in the state law, the committee was finally instrumental in bringing about proper amendments to the California Bank Act at the regular session, so that they felt able to come into the system.[1] The Bank Act, as amended in 1919, provided that any state bank which became a member of the Federal Reserve System should comply with the reserve requirements of the Federal Reserve Act in lieu of the state requirements.[2] The California reserve requirements were of the type which is considered characteristic of banking in the United States: The banks were required to keep a certain percentage of deposits as cash on hand and were permitted to deposit a part of the legal reserve with designated reserve depositaries, either national or state banks.[3] The percentage reserve required corresponded closely, though not exactly, with the original Federal Reserve Act requirements. The percentages were the same in the two, but the method of defining or classifying the banks for the percentages differed, as shown in the following table:

ORIGINAL FEDERAL RESERVE ACT REQUIREMENTS[1]

Banks	Demand deposits (per cent)	Time deposits (per cent)
Central reserve-city banks	18	5
Reserve-city banks	15	5
Country banks	12	5

CALIFORNIA REQUIREMENTS UNDER BANK ACT OF 1917[2]

Banks in places of	Commercial (per cent)	Savings (per cent)
100,000 population or above	18	5
50,000 and less than 100,000	15	5
Less than 50,000	12	5

[1] The Federal Reserve Act, 1913, Sec. 19. [2] California Bank Act, 1917, Secs. 20, 68.

[1] Hearings, p. 85.
[2] California Bank Act, 1919, Sec. 20.
[3] California Bank Act, 1917, Sec. 20.

The state requirements were simply more rigid than the Federal Reserve requirements, since not all cities of reserve-city size (50,000) are reserve cities and the minimum for central reserve cities is a population of 200,000 rather than 100,000, under the national law.[1]

At the time in question, however, the revised Federal Reserve requirements introduced in 1917 were in effect for national bank members and under the law became effective for state bank members.

Banks	Demand deposits (per cent)	Time deposits[1] (per cent)
Central reserve-city banks	13	3
Reserve-city banks	10	3
Country banks	7	3

[1] The Federal Reserve Act, Sec. 19, as amended June 21, 1917; see KEMMERER, "The ABC of the Federal Reserve System," p. 37.

Advantages of Membership.—Under the new law, which allowed the state bank to become a member of the Federal Reserve Bank and keep only the percentage reserve required by the federal law, there was an apparent advantage in membership, since the reserve required to be kept was considerably less than under the state law. This advantage, however, was partly nullified by the necessity of keeping till money on hand which could not count as part of the legal reserve and, also, by the fact that the Federal Reserve Bank does not pay interest on the deposited reserve. Since the state law had permitted the depositing of half of the required reserve, in all cases, the actual non-interest-bearing reserve would be increased in percentage by Federal Reserve membership at least from 9 to 13, 7.5 to 10, 6 to 7 for the demand deposits of the different classes of banks and from 2.5 to 3 for the savings or time deposits, besides whatever amount might be needed for till money.

At any rate, many of the large state banks came into the system after these changes had been made, even though as savings banks they could not often avail themselves of the great privileges

[1] 24 Stat. L., 559, Act of Mar. 3, 1887.

of the system[1] and though the reserve requirements were actually little, if any, more favorable. They came in at the solicitation of the President of the United States and the Federal Reserve authorities and after assurance had been given them that the Federal Reserve was not opposed to branch banking.[2]

Growth.—The growth of state bank membership in the Federal Reserve System from 1918 to 1924 is shown in the following table:

California State Bank Members of the Federal Reserve System[1]

Year	Number	Resources		
		Millions of dollars	Percentage of California state banks	Percentage of all state bank members in United States
1918	4	8	0.8	0.11
1919	22	445	39.4	4.6
1920	39	656	46.8	6.3
1921	53	844	56.4	8.5
1922	45	978	58.9	8.2
1923	43	1,142	57.5	8.9
1924	37	1,372	61.5	9.5

[1] This table has been computed from figures obtained from the *Annual Reports* of the Federal Reserve Board, 1918–1924, and the *Annual Reports* of the Superintendent of Banks of California, 1919–1924. The date taken for total assets of all state banks in California was about June 30, while for the Federal Reserve figures, the exact date is not given, except for the number of members, where it is Dec. 31. Resources are latest available each year.

Several things should be noted about the facts presented by this table. The resources of state bank members have been increasing continually in spite of the drop in numbers of such members in California. The percentage of all resources of state banks in California went up rapidly until 1921 and then changed but little. The percentage of resources of all state bank members in the United States has steadily increased. This indicates very clearly that the rapid spread of branch banking in the years 1920 to 1924 has added to rather than taken from the strength of the Federal

[1] Hearings, p. 143.

[2] Hearings, p. 59, letter from John Perrin, chairman of the board, Federal Reserve Bank of San Francisco, to J. F. Sartori, president of the Security Trust and Savings Bank, Los Angeles, Calif., Nov. 3, 1919.

Reserve System in California, for the California state bank members have formed an increasing part of the national total of resources.

Big Branch-bank Contributions.—The five outstanding branch-bank systems, the Bank of Italy, the Mercantile Trust Company of California, The American Bank, the Pacific-Southwest Trust and Savings Bank, and the Security Trust and Savings Bank, were all members of the Federal Reserve System in 1924 and contributed about $983,000,000 to the resources of the system. These five banks are engaged in both intracity and intercommunity branch banking on large scales. The United Bank and Trust Company with head office in San Francisco and branches in Sacramento and neighboring towns is a member of the system and contributes more than $48,000,000 resources. Three San Francisco banks, engaged in intracity branch banking exclusively, contributed resources to the amount of nearly $99,000,000. The Wells Fargo Bank and Union Trust Company operates the old Union Trust Company office as a branch but is not looked upon as a branch-banking system. This bank was formerly a national bank and has many country correspondents. It is a member of the Federal Reserve System and has resources of about $142,000,000. This is the only contribution of a non-branch-banking state bank of any considerable size. All of the other state bank members, including numerous small branch-banking systems, had resources of only about $99,000,000 in 1924. The nine larger branch-bank members contributed more than 82 per cent of the total resources for all state bank members of the Federal Reserve System in California, as shown in the following table (1924, latest date):[1]

	Resources	Per Cent of Total
Nine large branch-bank members	$1,130,804,000	82.4
Wells Fargo Bank and Union Trust Company	142,228,000	10.4
All other state bank members	98,871,000	7.2
	$1,371,903,000	100.0

Branch-bank Non-members.—While the branch banks have contributed largely to the state bank membership in California,

[1] *Annual Report* of the Federal Reserve Board, 1924, pp. 187–188. Compiled by the writer.

not all the branch banks were in the system by the end of 1924. The exceptions were certain of the large banks, which were engaged in city branch-banking only. Among these were three Los Angeles banks with combined resources of about $186,000,000 and one Oakland bank with resources of about $52,000,000. These four banks together account for more than one-fourth of the resources of all state non-member banks in California, though there were 373 such non-member banks in all.

RESOURCES OF NON-MEMBER STATE BANKS IN CALIFORNIA, JUNE 30, 1924

Bank	All	Commercial in millions of dollars	Savings in millions of dollars
Hellman Commercial Trust and Savings Bank	$ 69,319,966.53	30	39
California Bank...........	72,659,040.28	24	48
Citizens Trust and Savings Bank.................	44,286,957.09	15	29
The Oakland Bank........	51,947,830.31	10	41.6
Total of big city branch banks..................	238,213,794.21	79	157.6
All other non-member banks (approximately).........	619,202,000.00		

With the exception of the Hellman bank, these city branch systems are preponderantly savings banks rather than commercial banks. Even including the figures for the Hellman bank, their savings departments have twice the resources of the commercial. Over 80 per cent of The Oakland Bank's business, for example, is in the savings department. The Federal Reserve has little to offer such banks. It was designed to meet the needs of commercial ones.

CHAPTER IX

CHARACTERISTICS OF THE BRANCH-BANKING BUSINESS IN CALIFORNIA

Dominance of Savings Accounts.—Although the small country banks were first to engage in branch banking in California, the main growth of the system within recent times has been through the large city banks largely, if not predominantly, engaged in a savings-bank business.[1] These banks, unlike the mutual savings banks of New England and the East, are operated by officers and directors under control of the stockholding owners. Profits for the stockholders are, therefore, a prime consideration. The self-perpetuating board of trustees of the mutual type of savings bank has no corresponding incentive for the expansion of the bank's operations.[2]

For a savings bank, branches serve, for the most part, simply as agencies for the collection of additional deposits which may be invested in securities, mortgages, and sometimes in limited amounts of commercial paper. The advantage of having numerous collection agencies for this purpose is obvious. More deposits may be gained for investment and therefore for the profit of the stockholders.

The movement to increase savings deposits has resulted not only in the extension of branch systems but also in the establishment of a system of collecting small savings from hundreds of schools scattered through the state.[3] So far as branch banking is undertaken merely for the purpose of increasing savings deposits, its problems are relatively few and easily solvable. The receipt

[1] *Infra*, p. 101.

[2] *Cf. infra*, p. 143.

[3] The Bank of Italy is authorized to collect savings in several hundred schools. *Annual Report* of the Superintendent of Banks of California, 1924, pp. 511–514.

and disbursement of money at the branches requires little more than honesty and accuracy on the part of branch employees. For them no questions of great moment or involving a nicety of judgment arise. They receive and disburse but need have nothing to do with the employment of funds. Such branches may be operated much more cheaply than independent savings banks, which must not only receive deposits but also invest them. Investment in securities requires careful study, access to investment information, and the keenest kind of judgment. For such investment, no small bank can be adequately equipped with facilities and personnel, while the head office of a large bank can have no excuse for not being well equipped in both respects. Moreover, the improperly directed investment of the small bank must necessarily be less profitable, either as a result of low returns on superlatively safe investments or of outright losses on insufficiently investigated risky investments made for the sake of higher apparent returns.

If the branch-banking business in California were absolutely restricted to savings banks and these savings banks restricted to investments in securities, it is unlikely that there would be any references to a branch-banking problem in that state. Under the Bank Act of 1909 and its amendments, the three types of banking, commercial, savings, and trust, may be conducted as three departments, with a complete separation of accounts and assets, by a single corporation. As a rule, the large branch-bank systems combine at least the commercial and savings functions. Moreover, their balance sheets indicate a large investment of savings assets in Loans and Discounts; for example, the Bank of Italy, June 30, 1924, held loans and discounts of about $75,000,000 out of about $111,000,000 of assets in the commercial department and $132,000,000 out of $212,000,000 in the savings department. The following table presents the situation for the most important banks engaged in out-of-the-city branch banking:

IMPORTANT BRANCH BANKS, JUNE 30, 1924,[1] RELATION OF LOANS AND DISCOUNTS TO OTHER INVESTMENTS IN THOUSANDS OF DOLLARS

	Savings department		Commercial department	
	All assets	Loans and discounts	All assets	Loans and discounts
San Francisco banks:				
Bank of Italy	$211,676	$132,317	$110,979	$74,597
Mercantile Trust Company of California	82,748	59,903	63,391	29,794
United Bank and Trust Company of California	18,666	14,046	26,731	17,150
Banca Popolare Fugazi	16,566	11,048	1,855	1,201
Los Angeles banks:				
Security Trust and Savings Bank	151,002	89,395	52,608	38,374
Pacific Southwest Trust and Savings Bank	84,519	61,066	85,049	53,621
California Bank	48,160	26,461	24,499	12,904
Hellman Commercial Trust and Savings Bank	38,722	25,087	30,392	22,149

[1] *Annual Report* of the Superintendent of Banks of California, 1924, *passim*.

Loans and Discounts. City Branches.—A large item of loans and discounts, whether representing actual commercial loans or mortgages on real estate, indicates the need for a greater degree of local responsibility and judgment than would be necessary for the simpler type of savings-bank branch banking referred to above. At this point, however, a clear-cut distinction should be made between city branches, that is, practically, nearby branches, and outside branches. For the former, the lending function may easily be centralized in the head offices.[1] Ordinarily, the manager of a city branch receives requests for loans and transmits these requests with his recommendation to the head office, where they are acted upon, after the elaborate credit information there collected, preserved, and organized has been

[1] Hearings, p. 74. Mr. Elliott's testimony that city branches "loan very little money" and correspond "somewhat to your tellers' window of the national bank."

consulted.[1] A line of credit is frequently established by the head office for firms and individuals, and, in such cases, the branch manager has authority to make loans within the limits of the line of credit. He has no authority to make new loans. Daily reports of all transactions at each branch are transmitted to the head office. All loans and other transactions are carefully checked over at the head office. The amount of the accounting books kept in each branch depends partly upon the storage space available there, since some of the branches are in rented quarters, remodeled corner grocery stores and old corner saloons. It is thus apparent that these city branches are conducted under the very direct control of the head office. They have no advisory boards and are run by small forces of three to five men, occasionally as many as seven. A branch manager or, rarely, a vice-president is in charge. Above him is a supervisor who is responsible to the head office for several branches. There are no more legal limitations upon the functions which these city branches may perform than upon the parent bank, but, as a matter of practice, the branches are accorded little, if any, independent lending power. This undoubtedly varies with the different banks and with the method of establishing the particular branch. Branches established through the taking over of an existing bank would be likely to have more power than newly established branches.[2]

Country Branches.—The out-of-town or country branches differ greatly from city branches, both as a result of the distance from the head office and as a result of the method of acquisition. The ordinary city branch is established, not bought; the ordinary country branch is bought, not established. The characteristic method is for the parent bank to buy an independent bank, largely with cash, though always, if possible, with enough parent-bank stock to retain the interest of a local advisory board.[3] The

[1] Personal interview with Wesley Voddens, Mercantile Trust Company of California, Aug. 20, 1925.

[2] Hearings, p. 73. Mr. Elliott: "In any place where we have taken over a bank, the manager of that branch now lends to his customers without consultation in advance with the head office just as much as he could have loaned when he was a unit bank, to the individual."

[3] This discussion is based in part on an interview with P. J. Lawler, manager of the School Savings Department, Bank of Italy, Aug. 20, 1925.

directors of the former bank are made into an advisory board for the branch. If the president of the bank is an old man, he is likely to be made a vice-president of the parent bank, while, if he is young, he is ordinarily made manager of the branch. This explains the great number of vice-presidents listed by the large branch banks. One such bank had, in 1924, nearly thirty vice-presidents in charge of branches, fifty managers in other branches, besides ten vice-presidents in the head office, and several assistant vice-presidents in various branches.[1] Very few changes of personnel are made upon taking over the bank, and only rarely are employees shifted from one branch to another. This applies to country branches only, for, in the city, the men are shifted about much more freely.

The branch in the country is conducted in very much the same way that it had been conducted as an independent institution. It is permitted, in the case of some of the banks, at least,[2] to lend up to the full extent of its former lending power without first consulting the head office. The local advisory board supervises these ordinary loans, just as it did formerly as a board of directors. If the branch wishes to extend further credit, then the head office must be consulted, just as was done previously with the city correspondent, and about the same allowances must be made by the head office for the plea of the branch as would have to be made for the representations of the country banker anxious to further local interests.[3]

Advantages.—If the new situation is so similar to its predecessor, it is natural to ask wherein the difference lies and in what the financial advantage of the new relationship consists. The independent bankers charge that there is no economic advantage, that this type of branch banking has all the faults of branch banking as conducted in other countries and none of the merits, that the

[1] *Annual Report* of the Superintendent of Banks of California, 1924, pp 15–17.

[2] Hearings, p. 73; also Oliver's testimony, p. 153.

[3] Interview with Wesley Vodden, Mercantile Trust Company of California, Aug. 20, 1925. *Cf.*, also, Hearings, p. 74. Mr. Elliott: "Of course they operate on their own funds, but if there is an unusual demand for them—if there is a demand for loans in one place and not in another—the place that has the surplus funds is drawn upon to meet the requirements in the place where they need the money."

economies of branch banking are at least temporarily foregone in order to lure the independent bankers into a snare and to deceive the public as to the true situation, and that the sole purpose of the change is the aggrandizement of individuals.[1]

The desire for personal power is undoubtedly effective in causing overexpansion in various lines of business,[2] and the danger of overexpansion is greatly increased where the possibility of rapid expansion exists.[3] The penalty of overexpansion, however, is failure or at least greatly reduced earnings on invested capital. In other lines of business this penalty has been quickly felt.[4] Although the expansion in branch banking has been most pronounced within recent years, nevertheless the expansion has been going on for seventeen or eighteen years, at least, and it seems unreasonable to suppose that it could continue for so long, not merely if it were unprofitable, but even if it did not prove positively very profitable to the branch-banking systems. Any other view would imply that the individuals who are fostering branch banking have tremendous personal fortunes to throw away. From 1907 to 1926 none of the branch banks of California failed. We must conclude that the business has been profitable.

Profits for a branch-banking system, as for other business enterprises, consist in a spread between income and outgo. That branch banking may be profitable under California conditions, this spread must be equal to or greater than the spread which existed when the branches were independent banks, for, in purchasing the independent bank, the price paid would normally be at least sufficient to capitalize the profits of the bank as an independent unit. Obviously, the profits for the branch bank may be increased either as a result of lessened expenses or increased income, or both.

Increased Receipts. 1. Shifting of Funds.—In the banking business, increased receipts must ordinarily originate in increased amounts of interest and discount. As regards branch banking in

[1] MacDonnell, "The Community Bank *vs.* the Branch Bank," address before the Riverside County Bankers' Association, Jan. 27, 1923 (8 pp. unnumbered).

[2] Dewing, Arthur Stone, "Corporation Finance," p. 187.

[3] Lincoln, Edmond E., "Applied Business Finance," p. 178.

[4] Dewing, *op. cit.*, p. 206, 291–296.

California, such increased receipts may be expected from several factors influencing the interest and discount accounts. In the first place, funds are shifted about from the branch where the seasonal demand is light to that branch where the demand is temporarily heavy. In this manner, only the absolute minimum of funds is kept idle in reserve.[1] It may be objected that the country banker under such circumstances of light local demand for loans customarily deposits the excess funds with his city correspondent, thus realizing a certain amount of interest. The answer is obvious, that the customary 2 per cent rate allowed on such bankers' balances is, in all cases, less than might be obtained by the ordinary loan and discount operation. Further, it might be objected that the country bank does not need to leave much money thus on deposit but may invest the excess in readily convertible commercial paper bought through a note broker or through the city correspondent.[2] This practice, however, lessens somewhat the immediate availability of the funds as compared with a city bank deposit, introduces a slightly greater element of risk, and, at the best, involves a lower rate of return than could be obtained on an ordinary loan to a customer where the higher nominal rate is made still higher as a result of the usual 20 per cent deposit requirement.[3]

2. Larger Loans to Individuals.—A second closely related, but still distinct, gain is that derived from the legal and economic power to make larger individual loans. This is usually expressed in this form: The branch has back of it the whole strength and lending power of the parent bank. Thus, loans which the country banker would be compelled both by law and expediency either to turn over to his city correspondent or perhaps to lose completely, as, for example, to note brokers, may be undertaken without the slightest difficulty by the branch bank. For the lending bank the advantage of this possibility is great. A regular customer has received good service and is retained as a customer of the bank to borrow large and small amounts. His affairs are closely watched by the credit department, and he may be required to submit statements of condition at regular intervals.

[1] Hearings, p. 139.

[2] Lincoln, "Applied Business Finance," p. 439.

[3] *Ibid.*, p. 444, 449–452.

The long-run effect of this shifting about of funds through the branch system should be the approximate equality of rates of discount and interest throughout the territory served. The very existence, however, of a disparity in interest rates in different sections indicates not only a certain degree of immobility of funds but also the possibility of profit to the institution which serves to lessen this immobility.

3. Better Security Purchases.—Third, so far as it is necessary or desirable that investments should be made in securities, such investments may be made on better terms by the large branch-banking system than by the small independent bank. A better and more scientific knowledge of investments and the nearness to security markets alone would suffice to explain this.[1]

Decreased Expenses. 1 and 2. Smaller Personnel and Less Display.—Gains through lowering of expenses may arise from four sources. First, a smaller personnel suffices to run a branch and, second, a less pretentious building and less expensive furnishings may be used in a branch, since the name of the parent bank gives more prestige to the branch than even a very pretentious building can give to the small independent bank. Both of these gains are actually realized by the branch bankers in California. The gains are greater in the case of city branches than in that of out-of-town branches because of the current method of acquiring the latter through the purchase of independent banks. Since the same bank building is used for the branch as had been used by the independent bank, the saving in expense for quarters occurs only as business grows. An increase, however, in the volume of work regularly takes place, both because California is advancing in population and prosperity and because the branch has a greater lending power than the independent bank had. For the city branches, on the other hand, it is not necessary to wait in order to realize these gains. These branches are established in very modest quarters and are frequently manned by small forces of three to seven people.[2]

3. Less Duplication of Effort.—A third saving in expense comes from the elimination of duplication. This gain is most

[1] *Supra*, p. 100.

[2] Interviews with Wesley Vodden and W. H. Taplin, August, 1925; personal observation in San Francisco, Los Angeles, Berkeley, and Oakland.

marked in the field of credit investigation. It is wasteful for several agencies to conduct investigations simply to obtain the same result. Some country banks rest heavily upon their city correspondents for credit information, yet no bank may safely trust another bank or agency to supply all such information. The provision of a cheaper and more efficient credit service is an outstanding feature of branch banking.[1] From a multiplicity of sources information is gathered into one central office, there to be analyzed and kept ready for immediate use. The small bank cannot maintain an adequate credit department, though, of course, this lack may be partly compensated for by the more intimate personal acquaintance with the borrowers. Nevertheless, the great amount of losses and the large number of business failures under our system of small independent banks indicate that credit is extended altogether too frequently without a proper consideration of the borrower's ability to pay.[2]

4. Elimination of Expenses of Acquiring Correspondents.—Fourth, the expenses attendant upon acquiring and retaining country correspondents may be eliminated. The expenses arise both from direct efforts to get correspondents' accounts, such as traveling agents and advertising, and from the indirect effort, in the form of more and more free services to the correspondent, such as providing the correspondent with sight exchange, allowing the country correspondent to act as collecting agent and charge for collections while no charge is made for items which the city bank collects, investing excess funds of the country bank at its direction, and so on. In fact, these services have become so numerous and so expensive that, particularly at times of easy money, it is a serious question for the city bank whether there is any profit in handling country bank accounts and paying 2 per cent interest on the balance.[3] Moreover, the country bank may at any time withdraw its account. In other words, the tenuous bonds thus expensively formed and maintained may easily be broken and perhaps at a time most inopportune for the city bank. This feature is closely linked with the advantage of being able to shift funds about to gain the highest return. The

[1] Interview with W. H. Taplin, Aug. 20, 1925.

[2] Lincoln, "Applied Business Finance," p. 371.

[3] Westerfield, Ray B., "Banking Principles and Practice," p. 326.

parent bank has control of all of its funds and need not invest them in call loans but may find more profitable use for them without in any way endangering their liquidity or the safety of the bank.

Offsetting Disadvantages. *High Price.*—It is not to be supposed that all of these advantages are entirely without offsetting disadvantages. In the first place, as in the case of any expansion or consolidation, the price paid for the new properties may be more than enough to capitalize any gains which may be made through the use of the new units. In some cases, the California branch bankers appear to have paid excessive prices for the unit banks,[1] though this is not the rule. The danger that an unduly high price will have to be paid because of obstinate minority stockholders is eliminated by the provision of law which allows a bank to sell its assets to another bank with the consent of a bare two-thirds of the stockholders of each bank.[2]

Too Many Banking Offices.—The profitableness of branch banking may be reduced through the establishment of too many branches in the same community. The rule of the State Banking Department which requires the purchase of an independent bank in order to establish an out-of-town branch has prevented excessive establishment of such branches in the country communities.[3] No such rule applies to city branches, and in Los Angeles the number of branches appears to be excessive.[4]

Expenses of Coordination.—A third and very important offset consists of the increasing expenses of coordination and centralization as branches become more and more widely scattered and as the whole business increases in volume. Some of these expenses are direct, such as the expense for holding conventions of employees[5] and the large amount of paper work involved in numerous reports to the head office, as well as the cost of supervision, examination through traveling examiners, and the added expense of the more cumbersome method of passing on loans by both branch and head office instead of having the loans

[1] *The Independent Banker*, May-June, 1925, p. 2.
[2] Bank Act, 1913, Sec. 31*a*.
[3] The so-called "*de novo* rule"; *supra*, pp. 74, 79.
[4] *The Independent Banker*, March-April, 1926, p. 10.
[5] *Cf. Bankitaly Life*, September, 1922, Convention Number.

completely handled at the local bank. There exists, also, the possibility, a practical certainty, that after a certain size has been reached, considering the capacity of the men at the head of the bank, there will arise losses as a result of inadequate means of control of the huge and widely distributed organization. This third factor is based upon a recognition of the "law of balanced return." To quote Arthur S. Dewing:

> Economies are inevitable as the business increases in size . . . The economies are incidental to the automatic phases of the business. On the other hand, as the business enlarges certain wastes creep in which increase with greater rapidity than do the economies. These wastes, in contrast to the economies, pertain to all phases of the business where personal skill is required. They pertain to what one might call the humanities of business. The critical point in the expansion of any business is reached when the wastes incident to mere size overcome the economies.[1]

Legal Rather than Economic Limit.—If foreign experience may be taken as a criterion, it seems unlikely that the California branch-banking systems, limited as they are to the state, will reach and pass the most profitable size. Legal rather than economic factors set the limits for them.

[1] Dewing, "The Financial Policy of Corporations," vol. IV, p. 31.

PART III

TYPICAL BRANCH-BANKING DEVELOPMENT IN SELECTED STATES

FOREWORD TO PART III

In the chapters of Part III, the branch-banking developments in Michigan, New York, Massachusetts, and North Carolina are reviewed. The discussion shows the variety of forms of branch banking which have resulted from the different state laws governing its practice. The different types of branch banking may be considered to be: first, full-power or limited-power branches; second, city or state-wide systems; third, static or dynamic; fourth, limited or unlimited as to number of branches; and fifth, Northern or Southern. All of these types are represented in the states selected for discussion.

Michigan stands for the legally limited-function city type of branch banking; New York also represents city branch banking but with full-power branches; Massachusetts is like New York, except that the branches are limited in number. All three of these are Northern states, and in all, with the possible exception of Massachusetts, the growth of branch banking has been rapid in recent times. North Carolina represents the Southern type as well as the unlimited in power and geographic extent within the state. It also represents a static type of country branch banking.

Recent developments in Ohio, Maryland, Pennsylvania, and Virginia are interesting and might help to give a more exact picture of conditions in the United States at present. However, the official reports of these states are either unavailable or lacking in the necessary information for a proper study of the growth of branch banking under their state laws.

CHAPTER X

BRANCH BANKING IN MICHIGAN

The development of branch banking in Michigan has followed simpler lines than that in California. There are pronounced similarities and differences in the two developments, as will be indicated in the course of this survey of the Michigan experience. In both cases, the earliest branches were established in the eighties. Then followed a period of very slow growth and, in and after the war period, a very rapid growth.

Rulings of Attorney General.—As in California, the earliest branches were established without specific statutory authority, and after the branches had been in operation for a number of years, the question of their legality was submitted to the Attorney General of the state for an opinion. The opinion of the Attorney General (May 27, 1909) marked out the rights and powers of the banks under the existing terms of law:[1]

For answer to your second question I would say that no authority to establish branches is conferred upon banks by any provision of laws of this State. In the absence of statute a bank has no authority to establish branches at which a general banking business is conducted.

MaGee on Banks and Banking, p. 41
Atty. Gen. v. Oakland Co. Bank, Walk, p. 90.

While a bank has no authority to establish branches unless expressly authorized by statute so to do, it seems that it may have an agency for the transaction of some parts of its business in the city or village designated in its charter as the place where the bank is to be located and conduct its business.

In MaGee on Banking, p. 41, are compiled the provisions in force in the different states relating to the subject and of this State it is said:

"There is no law authorizing the establishment of branches. Agencies are permitted which are restricted in their operations to receiving and paying out of deposits and issuing exchange"; and several instances

[1] *Annual Report* of the Commissioner of the Banking Department of the State of Michigan, Dec. 31, 1924, Opinions of the Attorney General (9), May 27, 1909, p. xxxii.

of banks located in the cities of Detroit and Lansing having established agencies of this character are noted.

The agencies established by the banks at the cities indicated have been conducted by the banks for some time and the right of the banks to establish such agencies does not appear to have been questioned by the banking department or any officer of the State. In view of the foregoing I am of the opinion that a bank may establish agencies of the character of those herein within the limits of the city or village in which the bank is located. Inasmuch as a bank originally located in a village, and which becomes located in a city by the extension of the corporate limits of the city, has authority to conduct its business within the city, it would have the same right to establish agencies of this character as a bank originally organized within the city.

Respectfully yours,
Jno. E. Bird,
Attorney General.

This opinion is very similar to that rendered by the Attorney General of California some years earlier.[1] Both opinions upheld the legality of the form of branch banking then in existence in the respective states, and both referred to these branches as agencies. In the California ruling, however, the term "agency" was left undefined, with the consequence that the business conducted by the agencies was actually that of branch banks, while the Michigan ruling specifically restricted the agencies to routine matters of "receiving and paying out of deposits and issuing exchange." Moreover, a later California ruling permitted the establishment of agencies anywhere in the state,[2] but the Michigan ruling restricted such agencies to the city in which the parent bank was located.

Absence of Later Legislation.—The greatest difference between the two experiences is that the California rulings were but the beginning of a carefully worked-out system of branch-banking laws and regulations, while the ruling of the Michigan Attorney General has been accepted as final, and branch banking in Michigan has developed without any legislative enactments.[3] The only actual law directly touching upon branch banking was a provision of the state constitution which gave the legislature

[1] Oct. 7, 1903, *supra*, p. 29.

[2] 1905, *supra*, p. 30.

[3] This refers to domestic branches only. There has been a provision made for foreign branches. Michigan Bank Act, Sec. 4.

power to "create a single bank with branches."[1] This plainly does not refer to the ordinary present-day type of branch banking but rather to the state bank with branches familiar in banking history before the Civil War. At any rate, the legislature did not act in the matter, and therefore the power has no practical importance.

Recommendations.—While no legislation has been passed affecting branch banking, the need for such legislation has been apparent to those charged with the supervision of the state banks, and from time to time recommendations have been made in the annual reports. These recommendations, however, have been fewer than might have been expected under the circumstances, and they have dealt with only three specific points, capital requirements for village banks included within a city by extension of corporate limits,[2] approval of the securities commission for the establishment of branches,[3] and capital requirement for the establishment of branches.[4] None of these recommendations led to legislation, and no recommendations have been made in the annual reports since 1916. This is probably due as much to the futility of making the recommendations, which are uniformly unheeded, as to the feeling that no change is necessary.

In 1925, a senator from Detroit sponsored a bill which was designed to give the state commissioner of the banking department control over the establishment of new branches. Although some of the Detroit representatives favored it on the ground that the present uncontrolled situation led to a wasteful duplication of branches, the bill was lost in the house by a vote of thirty-eight to twenty-six. It was claimed by the opposition that it represented an attempt on the part of the large banks to keep down competition so that they might continue to maintain a low savings-bank rate on deposits.[5]

Thus, the Michigan banks are still exempt from this slight degree of control which is so common in other states where branch

[1] Michigan Constitution, Art. XV, Sec. 1.

[2] *Annual Report* of the Commissioner of the Banking Department, 1910, p. xxvii.

[3] *Ibid.*, 1914, p. xxii.

[4] *Ibid.*, 1915, p. xx; 1916, p. xix.

[5] *The Independent Banker*, May-June, 1925, pp. 9–10, reprint from *The American Banker*, May 16, 1925.

banking is practiced. As the experience in Los Angeles indicates, however, it is not easy for the banking authorities to administer the rule as applied to city branches alone, since no general principles of obvious application can well be laid down to govern the establishment of new branches.[1]

THE GROWTH OF BRANCH BANKING IN MICHIGAN, 1889–1925

The first branch bank in Michigan was established in Detroit, on May 1, 1889, by the Wayne County and Home Savings Bank and is still in operation.[2] Eleven years elapsed before another branch was established. This second branch was established by the Peoples State Bank, Detroit, in the year 1900. The growth of branch banking was very slow, but by the year 1909, "most of the Detroit banks had outlying branches," and there were a few branches in Grand Rapids. This slow growth continued until 1914, when the pace was somewhat accelerated. The period of most rapid growth, however, has been the most recent. In 1919 and 1920, many branches were established, and by 1922 there were 264 branches in the state.[3] In the next four years, nearly a hundred new branches were added, as is shown by the following table:[3]

NUMBER OF BRANCHES OF STATE BANKS IN MICHIGAN

Date	Branches	Increase
Sept. 15, 1922.....	264	
Sept. 14, 1923.....	274	10
Oct. 8, 1924.....	312	38
Sept. 28, 1925.....	354	42

[1] *Supra*, p. 85.

[2] Official statistics of branch banking in Michigan are not available for the years prior to 1922. Much information has been obtained from letters of George Wiley, vice-president of the Wayne County and Home Savings Bank; L. D. Heaphy, assistant cashier of the Peoples State Bank, both of Detroit; H. C. Moore, vice-president of the Industrial Savings Bank, Flint; E. C. Johnson, vice-president of the Grand Rapids Savings Bank; and D. E. Lawrence, chief examiner of the State Banking Department. These letters were written in February and March, 1926, in response to inquiries about certain phases of the branch-banking situation in Michigan.

[3] Figures obtained by compilation from the *Annual Reports* of the Commissioner of the Banking Department, 1922–1925.

There was a temporary slowing up in the rate of growth during 1922 and 1923, but the growth was very rapid in 1924 and 1925 and was still continuing at a rapid rate in 1926. In this whole development, the city of Detroit has played the dominant role. The fact that Detroit is the only large city in the state and that branch banking is confined by law to city limits serves to explain the predominance of Detroit in Michigan branch banking. In 1925, there were 265 branches in Detroit, 26 in Grand Rapids, 9 in Flint, and only 54 in all of the other cities and towns of the state.[1]

Geographical Distribution of Branches of State Banks in Michigan

City	Number of branches			
	Sept. 15, 1922	Sept. 14, 1923	Oct. 8, 1924	Sept. 28, 1925
Detroit	189	200	229	265
Grand Rapids	24	24	25	26
Flint	7	7	10	9
All others	44	43	48	54
Total	264	274	312	354

In these last two years there was an increase in branch banking in the smaller cities of the state where the movement was gaining momentum.

CAUSES OF GROWTH OF BRANCH BANKING IN MICHIGAN

A factor in explaining the early growth of branch banking in Michigan is the proximity of Detroit to Canada where branch banking has been the rule for many years. The pioneers in the branch-banking movement in Detroit were influenced by the success of their Canadian neighbors.[2] A second factor in causing the growth of branch banking, particularly in Detroit, has been the relatively high minimum-capital requirement for the estab-

[1] Compiled from the *Annual Report* of the Commissioner of the Banking Department, 1922–1925, *passim.*

[2] Correspondence.

lishment of independent banks. The minimum for banks in Detroit was set at $250,000.[1]

Automobiles.—The more recent development in Detroit has been affected in two independent ways by the growth of the automobile business. Detroit, as the center of the rapidly growing motor industry, has undergone a correspondingly rapid growth in population and business. This growth, of itself, has led to a great demand for increased banking facilities, which has been met by the establishment of branches rather than new banks. Moreover, the advent of the automobile has brought about traffic difficulties, particularly with regard to parking facilities, which make it desirable from the point of view of the bank customer that banking offices be established in uncongested parts of the city. If branch banking had been prohibited and if the capital requirement for independent banks had been lower, small independent banks, as in Chicago, for example, would have been established to meet this need. In Detroit, the need was met by the establishment of branches.

Savings Deposits.—The banks most actively engaged in branch banking in Detroit place their primary emphasis upon the accumulation and investment of savings deposits, of which, in 1924, they had $330,000,000 as compared with $159,000,000 of commercial deposits.[2] Only one bank in Detroit attempts to do a savings-bank business without the use of branches. This bank specializes in a "mailing business" and compensates its customers for the undoubted inconvenience of making their deposits and withdrawals by mail by paying them a higher rate of interest than that paid by the other savings banks of the city.[3]

Ultimately, then, the desire for larger savings deposits and, consequently, larger profits explains the recent rapid branch-banking expansion in Detroit. Therefore, if mutual savings banks were the rule instead of stock savings bank, there would probably be a very different story to tell.[4]

[1] *Annual Report* of the Commissioner of the Banking Department, 1910, p. xxi.

[2] *Ibid.*, 1924, p. lxxiii.

[3] Correspondence.

[4] Compare the situation in Massachusetts where there has been only the slightest development of branch banking by savings banks of the mutual type. *Infra*, p. 143.

CHARACTERISTICS OF THE BRANCH-BANKING BUSINESS IN MICHIGAN

Similarity to California City Branches.—The similarity between branch banking in Detroit and in Los Angeles and San Francisco is surprising in view of the differences in the branch-banking laws of the two states. This is particularly the case in the matter of making loans at the branches. The city branches in California have full legal power to make loans, while the Michigan branch banks are legally mere agencies with no power to make any loans. As a matter of practice, the city branches in California have very little independent loaning power. The banking policy of the large-city branch-banking systems permits the branch manager to pass on loans of very small amount and to make loans to firms and individuals within lines of credit established by the head office. Essentially the same policy is followed by the Detroit branch bankers. Little independence is permitted to the branch manager. He lends only within the limits of lines of credit established at the head office. In some cases, the Michigan branch bankers allow the branch manager to make loans of small amount, up to $500, for example, without first referring them to the head office. There appears to be no effort on the part of the State Banking Department to punish this violation of the law.[1]

In the type of investment, the similarity also appears. The real-estate mortgage constitutes the largest part of the investments. In 1925, the Detroit state banks engaged in branch banking had $260,000,000 of their $332,000,000 of savings accounts invested in "bonds, mortgages, and securities."[2]

Differences.—In minor matters of business policy, certain differences appear. Some of the San Francisco banks rent many of the locations for their branches and make use of remodeled buildings. As a rule, the Michigan branches are established in quarters owned by the parent bank, and in some cases the policy

[1] Lawrence, D. E., chief examiner: "In our larger cities it has become a practice to establish branches within the municipality itself, which are confined entirely to offices of deposit and withdrawal only. I have in mind possibly three or four exceptions to this rule." Letter, Mar. 9, 1926, at Lansing, Mich.

[2] *Annual Report* of the Commissioner of the Banking Department, 1925, p. lxxvii.

of making the branch building a small replica of the head office is followed.[1]

From the earliest days of California banking, it has been characteristic to lay great emphasis upon the safekeeping of valuables, and the branches are usually equipped with safe-deposit vaults.[2] On the other hand, the Detroit branch bankers have found little profit in establishing safe-deposit vaults in their branches. Only one of the forty-six branches of the Peoples Bank in Detroit is equipped to do a safe-deposit business. Perhaps the disastrous fires and earthquakes of the Pacific Coast cities account for this difference.

THE NATIONAL BANK QUESTION IN MICHIGAN

Comptroller's Statements.—In his report for the year 1923, the Comptroller of the Currency, Henry M. Dawes, makes this statement:[3]

> In the State of Michigan upward of 300 branches of State banks are in operation. In the city of Detroit 14 banks are operating about 200 branches, and there are in Detroit only 3 national banks left in operation.

Again, in the 1924 report, he refers to this situation, "the city of Detroit, with a population of 993,678, having only three national banks left."[4] In the testimony before the House Committee, in April, 1924, he presented the same evidence, emphasizing the size of the cities, Detroit, Cleveland, and New Orleans, and the small number of national banks "left" in them.[5]

This colloquy from the report of the hearings before the House Committee indicates both the form of the argument and the natural conclusion:[6]

> Mr. Dawes: "Mr. Goldsborough, I would like to say this: There are three cities where State banks have had unlimited operations, prac-

[1] Correspondence.

[2] WRIGHT, "Banking in California 1849–1910," p. 15, "It seems that the chief essential required for one willing to take up the banking business at that time was to be the owner of a safe in a well-protected building."

[3] *Report* of the Comptroller of the Currency, 1923, p. 6.

[4] *Op. cit.*, p. 4.

[5] Hearings, p. 15.

[6] *Ibid.*, p. 30.

tically, in branch banks: Detroit, Cleveland, and New Orleans. The national banks have not been able to meet them; the result has been the extinction of national banks and the greater development of the State banking system. That is a practical fact and, I think, can not be disputed."

Mr. Strong: "It looks like we have either to establish the branch banking system and limit it to cities—either do that to meet the situation that the States have created by allowing the State banks to have unlimited branches—or have our national banking system destroyed."

Number of Banks.—It is important, therefore, to consider whether the Comptroller has made a proper presentation of the case. His statement that there are only "three national banks left" in Detroit is misleading, since it implies some recent change in the matter. Twelve years ago there were only three national banks left in Detroit, and, indeed, at one time in that year, 1914, there were only two.[1] It is true that there were as many as five national banks in the city prior to 1908. One of these was liquidated in 1908. The American Exchange National Bank was absorbed by the Old Detroit National Bank in 1911.[2] Thus, years before the period of rapid growth of branch banking, the number of national banks in Detroit was reduced to three. In 1914, the First and Old Detroit National Bank succeeded the First National Bank and the Old Detroit National Bank, and in the same year the Merchants' National Bank was chartered.[3] Since that time, only two changes have taken place: the name of the First and Old Detroit National Bank was changed to the First National Bank, in 1922, and a charter was issued to the Griswold National Bank, Nov. 11, 1925.[4]

Amount of Deposits.—From 1903 until 1915 there was an increase in the total deposits of national banks in Detroit both in absolute amount and as a percentage of the combined deposits of state and national banks. This percentage increased from 23 to 29 per cent. The absolute amount of national bank deposits nearly doubled in the years from 1915 to 1919, but the state

[1] *Report* of the Comptroller of the Currency, 1914, p. 324.

[2] *Ibid.*, 1908, p. 250; 1911, p. 128.

[3] *Ibid.*, 1914, pp. 14–15.

[4] *Annual Report* of the Commissioner of the Banking Department, 1922, p. 320; 1925, p. 344.

bank deposits increased somewhat more rapidly, so that the proportion held by national banks was reduced from 29 to 26 per cent during this period of slow branch-banking expansion. During the period of rapid growth of branch banking, from 1919 to 1925, the total deposits of national banks in Detroit have continued to increase rapidly, only slightly less rapidly than those of the state banks, so that the percentage declined merely from 26 to 25 per cent.

The national banks, however, are primarily commercial banks, while the state banks have a much larger amount of savings accounts than of commercial. The Detroit national banks had no savings accounts in 1915, only $7,000,000 in 1919, and $37,000,000 in 1925. The state banks had $102,000,000 in 1915, $199,000,000 in 1919, and $335,000,000 in 1925. The percentage and absolute amounts of commercial deposits have followed the same course as the total deposits. The absolute amount of national bank commercial deposits increased throughout the whole period; the share of all such deposits in the city increased until 1915 and declined slightly thereafter.

COMPARISON OF DEPOSIT FIGURES OF DETROIT NATIONAL AND STATE BANKS[1]

	1903		1915		1919		1925	
	In millions of dollars	Per cent of total	In millions of dollars	Per cent of total	In millions of dollars	Per cent of total	In millions of dollars	Per cent of total
All deposits:								
National	$20	23	$ 71	29	$127	26	$190	25
State	67	77	176	71	360	74	557	75
Both	$87	100	$247	100	$487	100	$747	100
Commercial deposits:								
National	$12	36	$ 51	44	$ 99	40	$122	39
State	21	64	64	56	146	60	191	61
Both	$33	100	$115	100	$245	100	$313	100

[1] *Annual Reports* of the Commissioner of the Banking Department, 1903–1925, *passim.*

Conclusion.—The national banks have not been driven out of Detroit by branch banking. Although their number has remained almost constant, their business has increased almost as rapidly as that of the state banks.

Banks Outside Detroit.—Outside Detroit the situation is somewhat different. The state banks have engaged in branch banking to a very slight extent; nevertheless, the proportion of deposits held by national banks declined from 39 per cent, in 1903, to 29 per cent, in 1919; from 1919 to 1925, the national bank share increased slightly from 29 to about 30.5 per cent.

Deposits of National and State Banks in Michigan Outside Detroit

	1903		1915		1919		1925	
	In millions of dollars	Per cent of total	In millions of dollars	Per cent of total	In millions of dollars	Per cent of total	In millions of dollars	Per cent of total
National	$ 55	39	$108	31	$187	29	$262	31
State	86	61	239	69	458	71	594	69
Both	$141	100	$347	100	$645	100	$856	100

The change which has taken place since 1915 in the case of the national banks outside Detroit has been the rapid acquisition of savings deposits. In 1915, they had only $47,000,000 of savings deposits as compared with $56,000,000 of commercial accounts; by 1924, the amount of commercial accounts had increased only to $89,000,000, while the savings accounts amounted to $142,000,000. No such change had taken place in Detroit, where the national banks' savings accounts of $37,000,000, in 1925, were almost negligible in comparison with their $190,000,000 of total deposits. Branch banking by state banks has greatly restricted the savings-bank business of the national banks in the city of Detroit. It is not quite correct, however, to assume that the national banks are entirely barred from branch banking in Michigan, though such development has been comparatively slight.

Two small state banks, one in Jackson and the other in Battle Creek, having converted into national banks, continued to operate one branch each.[1] Under the authority of the Consolidation Act of Nov. 7, 1918, the Grand Rapids National Bank operated nine branches in the city of Grand Rapids.[2] In 1924, the First National Bank in Detroit was authorized by the Comptroller to

[1] *Report* of the Comptroller of the Currency, 1925, p. 15.

[2] *Ibid.*, p. 15.

open twenty "additional local offices."[1] Moreover, this bank had a community of interests with the Central Savings Bank through joint stock certificates,[2] and the Central Savings Bank had nineteen branches in 1924.[3] These branches were apparently worked together, for the correspondence indicates, only one separate branch of a national bank in Detroit, a branch of the National Bank of Commerce.[4] This was an additional local office authorized by the Comptroller in 1922.[5] In Flint, Jackson, Ludington, Muskegon, and Saginaw, one national bank in each place was authorized to open an additional local office.[5]

From the action of the First National Bank in Detroit in not consolidating with the Central Savings Bank and from the very small number of state banks converting into national with their branches, it is apparent that it was not deemed profitable to undertake the savings-bank business under a national rather than a state charter. The fact that the national law made no adequate provision for the conduct of a savings-bank business by national banks is the explanation of this preference for state charters. Under Section 24 of the Federal Reserve Act, a national bank was permitted to receive and pay interest on time deposits and to invest in real estate mortgages "in an aggregate sum equal to twenty-five per centum of its capital and surplus or to one-third of its time deposits."[6] Such a limitation of mortgage investments was a serious disadvantage for a national bank which wished to do any large amount of savings-bank business. However, the most serious limitation upon mortgage investments of national banks was the restriction of loans on city real estate to a maturity of one year or less.[7]

The McFadden Act, 1927.—In February, 1927, the McFadden National Bank Bill was finally enacted by Congress.[8] This

[1] *Ibid.*, p. 17.

[2] Heaphy, L. D., letter cited above.

[3] *Annual Report* of the Commissioner of the Banking Department, Michigan, 1924, p. 84.

[4] Heaphy, letter cited above.

[5] *Report* of the Comptroller of the Currency, 1925, p. 17.

[6] The Federal Reserve Act, Sec. 24, as amended by act approved Sept. 7, 1916.

[7] *Ibid.*

[8] *Infra*, pp. 178–182.

Act provides that national banks may make loans on city real estate with a maturity of five years and, further, that they may invest up to 50 per cent of their time deposits in such loans on real estate.[1] These provisions, along with the permission to establish intracity branches also accorded by the Act, will undoubtedly allow the Michigan national banks to compete on a more nearly equal basis with the state banks conducting a savings-bank business. It seems, however, that the Act does not accord positive competitive advantages to national banks over state banks, and it is therefore unlikely that conversions into the national system will be common.[2]

BRANCH BANKING AND THE FEDERAL RESERVE SYSTEM IN MICHIGAN

The importance of the relationship of the branch banks to the Federal Reserve System is much less in Michigan than in California, since the effort to use the Federal Reserve System to curb the expansion of branch banking has been directed mainly, if not entirely, at the out-of-the-city type of branch banking which is not practiced in Michigan in any case. Nevertheless, it is important to consider the contribution of state banks, and particularly state banks with branches, to the resources of the Federal Reserve System, since it is frequently claimed that the national banks, as compulsory members, furnish the only reliable basis for the existence of that system.[3]

The provisions of the Michigan banking law are sufficiently liberal as regards Federal Reserve membership of state banks, permitting them to become members, to purchase stock of the Federal Reserve Bank, and to keep reserves in accordance with the provisions of the Federal Reserve Act in lieu of the state requirements as imposed upon non-members.[4]

Michigan state banks were among the first to come into the system in appreciable numbers, although, like the banks of other

[1] *Infra*, p. 180.

[2] Prominent state bankers expressed the opinion to the writer that the state charters would be better even with national permission to have branches and lend on mortgages.

[3] Hearings, *passim*.

[4] Banking Law, Sec. 4.

states, few, indeed, came in before the changes in the federal law in 1917.[1] Two relatively small banks had joined the system in 1915, but in 1917 the state banks began to join rapidly, and the number of members reached 35 by the end of the year. This rapid increase in state bank membership continued through 1918 and 1919, reaching a total of 146 by the end of that year. There was a slow growth up to the maximum in 1921 of 165, from which there was a recession to 162 by September, 1925. However, as in other comparisons of the sort, the best basis of comparison is not the number of banks but rather the amount of resources which takes into consideration the size of the banks as well as their number. The following table is designed to show the growth of the state bank membership in the Federal Reserve System in the state of Michigan:[2]

Michigan State Bank Membership in the Federal Reserve System, 1915–1925

Year	Number of banks		Resources in millions of dollars		Percentage
	All	Members	All	Members	
1915	478	2	$ 485.7	1.0	0.21
1916	492	2	607.4	1.2	0.20
1917	511	35	668.5	306.4	45.83
1918	521	117	729.8	476.5	65.29
1919	532	146	980.5	643.6	65.64
1920	549	157	1,086.1	758.8	69.88
1921	570	165	989.9	685.3	69.234
1922	581	164	1,070.4	718.9	67.163
1923	588	164	1,179.4	821.3	69.638
1924	600	163	1,292.9	893.7	69.13
1925	602	162	1,453.1	1,009.1	67.9

Though only about one-fourth of the state banks were members of the Federal Reserve System, they had more than two-thirds

[1] *Supra*, p. 93.

[2] *Annual Reports* of the Federal Reserve Board, 1915–1925, and *Annual Reports* of the Commissioner of the Banking Department, 1915–1925. Compiled. The figures for "all state banks" includes a small number of trust companies and industrial banks, varying from year to year. In 1925, for example, there were two such industrial banks and eighteen trust companies.

of the resources of all state banks in Michigan. The member banks were, as a rule, larger than the non-member and were city banks rather than small-town banks. Since most of the city banks had branches, the members of the Federal Reserve System were, to a large extent, banks with branches.

The extent and character of branch-bank contributions to the strength of the Federal Reserve System are shown by the following table of branch banks in Detroit:

DETROIT STATE BANKS WITH BRANCHES, SEPT. 28, 1925

	Branches	Capital funds in thousands of dollars		Resources in thousands of dollars
		Total	Average per branch	
Federal Reserve members:				
The American State Bank	23	$ 2,829	$106	$ 32,952
The Bank of Detroit	17	2,889	146	48,792
The Central Savings Bank	28	1,908	54	35,768
Commercial State Savings Bank	8	1,229	104	8,789
The Detroit Savings Bank	25	3,955	142	42,171
The Dime Savings Bank	21	4,780	209	63,601
The First State Bank of Detroit	15	3,394	200	24,730
Peninsular State Bank	28	4,528	147	49,201
The Peoples State Bank	46	16,165	343	162,660
Wayne County and Home Savings Bank	36	12,551	338	120,009
Ten member banks	247	54,228	203	588,673
Non-member banks				
Commonwealth Federal Savings Bank	12	1,083	57	14,343
Michigan State Bank of Detroit	4	329	20	3,468
The Northwestern State Bank	2	58	19	1,689
Three non-member banks	18	1,470	50	19,500

The average capital per branch is found by subtracting the required capital from the capital funds and dividing by the number of branches. The required capital for the ten member banks is $400,000 each. The same holds for the first non-member. The second has a required capital of $250,000; and the third, only $20,000.

All of the large branch banks in Detroit were members of the Federal Reserve System. Only one of the non-member banks even approached in size the smallest of the member banks. All of the member banks and the largest non-member bank had sufficient capital as measured by the standards maintained in other states by state law, $25,000 or $50,000 additional capital for each branch. The two small non-member banks would have been deficient, if measured by such standards.

FEDERAL RESERVE MEMBERSHIP OUTSIDE DETROIT

Outside Detroit, as well as within, the characteristic situation was for the branch bank to be a member of the Federal Reserve System. Branch banking was carried on in twenty-seven cities and towns besides Detroit. However, fifty-one of the eighty-nine branches outside Detroit were located in the four cities, Highland Park, nine; Grand Rapids, twenty-six; Flint, nine; and Bay City, seven. In 1924, there were twenty-three of these "country" branch-banking systems, having a total of fifty-eight branches, who were members of the Federal Reserve System, while there were sixteen non-members with twenty-five branches. The resources of the former were about $192,000,000 and of the latter about $46,000,000, that is, about 81 per cent of the resources of such country branch-banking systems were in the Federal Reserve System. Here, as in Detroit, all of the larger banks were in the Federal Reserve System, and the average resources of member banks were $8,352,000 as compared with $2,864,000 for the non-member banks.

The situation may be presented more forcibly in a summary showing the division of the total banking resources of the state among the various groups of banks concerned:

Division of All Resources of Banks in Michigan,[1] Oct. 8, 1924

	Millions of dollars	Per cent of total	Per cent of total
Federal Reserve members:			
National banks	488.5	27.8	
Branch banks	705.0	40.1	
Unit state banks	171.9	9.8	
All member banks	1,365.4	....	77.7
Non-member banks:			
Unit banks	324.4	18.5	
Branch banks	67.4	3.8	
All non-member banks	391.8	....	22.3
Both member and non-member	1,757.2	....	100.0

[1] *Annual Report* of the Commissioner of the Banking Department, 1924, *passim.* Compiled by the writer.

The branch banks have contributed more to the Federal Reserve resources than any other group of banks involved, far more than the unit state banks, considerably more than all the national banks; moreover, very few of the branch banks are non-members. Nevertheless, this contribution should not be misconstrued as a direct result of branch banking. It is simply the result of the fact that large city banks have found it more desirable to become members than have the small country banks. Still, on the other hand, since branch banking tends to build up larger banks, to that extent it has had something to do with the growth of Federal Reserve strength in Michigan.

POSITION OF MICHIGAN IN THE BRANCH-BANKING CONTROVERSY

The bankers of Michigan were not actively engaged in the national branch-banking controversy. The small country banks were not affected by branch banking as practiced in Michigan, and the large national banks in the cities appear to have accepted the situation without protest. As early as 1922, two of the presidents of large national banks in Detroit spoke favorably of the public service rendered by branch offices of the type used by the state banks in Detroit. They desired that the same power to render such service be extended to national banks.[1]

Before the McFadden Act, some national banks had additional local offices with the permission of the Comptroller of the Currency and under a ruling of the United States Attorney General;[2] it is unlikely that the passage of the national legislation authorizing local offices of national banks will have great practical effect on the situation in Michigan, though it may have a beneficial psychological effect in removing any fear which may have existed as to the legality of the existent "additional offices."

[1] Emery W. Clark, president First National Bank, Detroit; Richard P. Joy, president, National Bank of Commerce of Detroit; *The Banker's Magazine*, vol. 105, p. 797.

[2] Opinion of Attorney General Harry M. Daugherty, Oct. 3, 1923.

CHAPTER XI

BRANCH BANKING IN NEW YORK

Removal of Early Prohibition.—From the passage of the amendment to the Free Bank Act, in 1844,[1] down to the year 1898, branch banking in New York was prohibited by law. In the general revision of the banking laws in 1892, the earlier prohibition laid down by the act of 1844 was merely made more specific,[2] but in 1898 this traditional policy of prohibition was abandoned. In that year, certain New York bankers, wishing to establish branches within the city of New York, easily obtained from the legislature a change in the banking law to the effect that any state bank in the city of New York might legally establish branches within the city limits.[3] The law provided that the written approval of the superintendent of banks must be obtained, but the Attorney General interpreted this provision as leaving no discretion to the superintendent in granting the approval.[4]

Early Growth.—Three banks quickly engaged in branch banking in the city, and by 1902 they had twenty branches; the Colonial Bank had five branches, the New York Produce Exchange Bank, four branches; and the Corn Exchange Bank, ten branches.[5] From that beginning, the movement spread rapidly, and by 1906 there were twenty-three banks with a total of ninety-one branches in the city of New York.[6] At that date, the superintendent of banks, feeling the need of better control of this rapid expansion, recommended that the statute be amended to permit him to exercise the same discretion in the approval of new branches as of new banks.[7]

[1] *Supra*, p. 8.
[2] New York Laws, 1892, Ch. 689, Sec. 89.
[3] New York Laws, 1898, Ch. 410.
[4] *Annual Report* of the Superintendent of Banks of New York, 1906, p. xxxi.
[5] Forgan, James B., "Branch Banking," *Sound Currency*, vol. IX, p. 100.
[6] *Annual Report* of the Superintendent of Banks, 1906, p. vii.
[7] *Ibid.*, p. xxxii.

Panic of 1907.—This recommendation was not acted upon, and the following year, Superintendent Williams repeated the proposal of his predecessor with an emphasis made possible by the events of the panic year of 1907.[1]

> The experiences in October had direct bearing upon the system . . . Seven of the ten suspended institutions had branches—in all 21. In several cases the failure may be attributed in some measure to this fact. As the company became weakened, the additional exposure rendered possible by the existence of these branches greatly increased the embarrassment.[2]

A committee of leading bankers of New York City was appointed by the Governor of New York to advise him as to desirable changes in the state banking laws. The two main criticisms of this committee were directed at the unrestricted establishment of state banks and trust companies and the unrestricted establishment of branches by these institutions.[3]

New Restrictions, 1908.—Besides the request for power to exercise his discretion in granting permits for new branches, Williams asked that there be a provision for a legal minimum additional capital of $100,000 for each branch. These recommendations were enacted into law Apr. 27, 1908.[4] No branch was to be opened until the superintendent of banks granted his approval, which might be given or withheld in his discretion but which must not be given until he had ascertained that "public convenience and advantage" would be promoted by the proposed branch. The minimum additional capital was fixed at $100,000 for new branches, but existing branches might be continued with only $50,000 additional capital. Essentially the same provisions applied to trust companies, except that trust companies were required to maintain a minimum of $100,000 additional capital for all branches and that trust companies anywhere in the state were permitted to open branches in the city named in the certificate of incorporation as the place of the company's business.[5]

[1] *Ibid.*, 1907, pp. xliv–xlv.

[2] *Ibid.*, p. xxviii.

[3] *Annual Report* of the Bank Commissioner of Massachusetts, 1907, p. xxxvi.

[4] Laws of New York, 1908, Ch. 156.

[5] Digest of State Banking Statutes. Compiled by WELLDON, SAMUEL A., National Monetary Commission, p. 486.

These provisions of law remained in effect unchanged until 1919, though Superintendent Richards mildly suggested in 1916: "I believe . . . that some extension of the power to open and occupy branch offices of financial institutions in the large cities, under proper restrictions, might well be considered."[1] In 1919, the law was amended to permit banks in cities with a population of 50,000 or over to establish branches.[2] The earlier law had restricted branches of banks to places of 1,000,000 population, as a minimum, that is, to New York City.

Development.—The development under these permissive and regulative acts was considerable. The net increase in branches of both banks and trust companies seems to have averaged about ten a year down to the year 1918.[3] In 1919, however, the increase was quadrupled; fifty permits were issued for new branches, and only eight branches were closed; this meant a net increase of forty-two branches, as compared with five in 1917 and twelve in 1918.

As regards the subsequent development, Superintendent Skinner, in his 1919 report, says:

> While there has been a very considerable development of branch banking through the opening and maintenance of branch offices during the year, this department has endeavored to be as conservative in the approval of new branch offices as in the authorization of new institutions. A number of branch offices, however, have been approved in interior cities of the State where branch banking, if practiced at all, has been attempted only on a very limited scale.[4]

He continues in a presentation of arguments in favor of branch banking and suggests that the statute might be amended to permit the establishment of branches outside the city limits within a twenty-five-mile radius of the head office. He feels that such branches should be permitted only where there is a real need for additional banking services which the local banks are not in a position to render.

[1] *Annual Report* of the Superintendent of Banks, New York, 1916, p. 8.

[2] BIRDSEYE, "Consolidated Laws," New York, 2nd ed., vol. 10, pp. 93–94; *Laws*, 1919, Ch. 37.

[3] Computed from lists of permits issued by the superintendent of banks, as given in annual reports. These reports are much less satisfactory for such computations than the California and Michigan reports, since the full situation at any one time is not shown but merely changes.

[4] *Annual Report* of the Superintendent of Banks, New York, 1919, p. 26.

> Any amendment of this character, should, therefore, in my judgment, provide that such a branch office should not be established in any place where it would come in competition with an independent institution after its establishment. It might be said that this condition as phrased would enable a strong institution to maintain branch offices by purchasing control of existing institutions and transforming them into branches.[1]

This he considers an advantage, since "certain too optimistic" ventures have already been eliminated in such a fashion. These recommendations were not acted upon.

By June, 1924, the number of branches of banks in New York had increased to 359, which were divided as follows: 71 branches of national banks, 229 branches of state members of the Federal Reserve System, and 59 branches of non-members.[2] The Comptroller's figures for April, 1924, show that there were 82 branches of national banks in New York City at that time and 167 branches of state member banks. The state member banks holding these 167 branches numbered 22, and there were 15 of the national banks in New York city engaged in branch banking.[3] The preponderance of the development in that city over the remainder of the state is apparent. There was only one large system outside New York City, the Marine Trust Company in Buffalo, which had 26 branches.

Leadership.—In New York, as in California, a relatively small number of banks have established such a large number of branches that they occupy a position of leadership in the movement, though this leadership is less pronounced in New York than in California. However, the following eight banks had about 60 per cent of the branches of all member banks in New York City:[4]

	Branches
Corn Exchange Bank	52
Bank of the Manhattan Company	31
Public National Bank	17
Chatham Phenix National Bank	12
Mechanics & Metals National Bank	12
Irving Bank—Columbia Trust Company	12
Manufacturers Trust Company	12
All eight banks	148

[1] *Ibid.*, pp. 49–50.

[2] *Federal Reserve Bull.*, December, 1924, p. 939.

[3] Hearings, p. 38.

[4] *Ibid.*

It is to be noted that the three largest banks in the city are not included in this list; the National City Bank had but seven branches in the city even as late as January, 1926, only five at the time of this tabulation. The large number of foreign branches of the National City Bank, especially in Cuba,[1] indicate that the lack of city branches is a matter of business policy and not the result of any aversion to branch banking. The Chase National Bank had only seven branches, and the Guaranty Trust Company, only two. The fact that the Guaranty Trust Company had only two branches would seem to indicate that the pressure for the establishment of branches by the largest banks is not so strong as is sometimes supposed.[2] Here was a large, strong state institution which was permitted by state law to establish branches, yet it had chosen to establish only two.

The Corn Exchange Bank has been a leader in the movement both in point of time and in number of branches, since it had ten branches as early as 1902[3] and in 1924 had three times as many branches as the Public National Bank, which stands third in the list, and almost twice as many as the second bank on the list, the Bank of the Manhattan Company.

Consolidations.—Numerous consolidations are a feature of the New York situation. These consolidations affect branch banking in two ways: A national or state bank may acquire a bank with a system of branches already established, or previous independent banks are acquired and converted into branches. Usually, the latter is involved, also, in the former, since the head office is maintained as a branch.

Specific reference to some of the recent consolidations is of interest. The Manufacturers Trust Company, originally the Citizens Trust Company, had, by June 1, 1924, increased its branches to fifteen through the process of absorption of independent banks. In this process it had absorbed ten or twelve state and national banks.[4] This bank endeavored to capitalize whatever antipathy may exist against branch banking or, at

[1] *Report* of the Comptroller of the Currency, 1922, pp. 85–88.

[2] *Supra*, p. 120. *Cf.*, also, COLLINS, "The Branch Banking Question, p. 51.

[3] *Supra*, p. 130.

[4] *The Commercial and Financial Chronicle*, vol. 120, p. 2898.

least, to avoid this antipathy by referring to the branches as "unit banks." Mr. Jonas, president of the Manufacturers Trust Company, states: "Decentralization into strong units—not centralization—is the policy of unit banking." In reference to lending, he continues:

> An office may have a number of loaning officers, each with a different limit on the amount of funds he can lend. A junior loaning officer, without consultation with any other officer, can lend up to a certain amount determined by his position and previous experience . . .

and so on for the other officers.

> If a combination of two or three officers agree that an even larger loan is justified, they can make it—within fixed limits—without reference to any other office of the company. Under this unit system plan, decisions on loans are made promptly at the office where the applicant banks and where he is best known.[1]

This plan of the Manufacturers Trust Company appears to have advantages in avoiding undue delay in passing on loans and in giving proper consideration to personal knowledge of loan applicants. However, it is still branch banking.

Another interesting consolidation, which shows something of the state-national possibilities as well as the method of acquiring a ready-made system of branches, is the merger of the American Exchange National Bank with the Pacific Bank. At the time of the merger announcement,[2] the president of the national bank stated that his bank, "being unable legally to establish branches of our own," had acquired some years ago, through the American Exchange Securities Corporation, control of the Pacific Bank, an old state institution, "having offices at desirable locations in New York City." He continued:

> We believe that the time has now arrived when these banks should actually merge, and thus permit the American Exchange National Bank to function to the fullest extent through the operation of the branches in the new centers.

[1] *Ibid.*, p. 2898.

[2] *The Commercial and Financial Chronicle*, vol. 120, p. 2646.

From this it is apparent that a national bank may be practically engaged in branch banking, that is, by the means of a controlled state institution, while apparently it has no branches. This situation has been found in every state studied.

An important merger is that of the Chase National Bank and the Mechanics & Metals National Bank, which took effect Apr. 12, 1926.[1] As a result of this merger, the Chase National Bank had twenty branches in the city.[2] The Mechanics & Metals Bank was one of the oldest banks in the city since it had been founded in 1810 and, besides other mergers and changes of charter in the meantime, in 1920 it had consolidated with the New York Produce Exchange National Bank, which, as a state bank, had been one of the three pioneers in branch banking in New York.[3] This consolidation brought to the Mechanics & Metals Bank nine branches, and a consolidation with the Lincoln National Bank, in July, 1922, increased the number by three.[4]

In December, 1925, there was a rumor of a "billion-dollar five-bank merger" of which the consolidation of the Chase National Bank and the Mechanics & Metals Bank was to be a part. So much of the consolidation had taken place by the end of 1926. A newspaper comment referred to the rumored combination as the greatest in the history of Wall Street and stated that such a combination would make "the consolidated bank equal in capital and resources with some of the most powerful London banks, including their many branches."[5] It is interesting to note that James B. Forgan, the distinguished Chicago banker, in the year 1902, in speaking to a group of bankers, expressed the hope that, through branch banking and consolidation, American banks might become large enough to compete with European banks for foreign business.[6]

[1] *Ibid.*, vol. 122, p. 1997.

[2] *Ibid.*, vol. 122, p. 1998.

[3] *Supra*, p. 130.

[4] *The Commercial and Financial Chronicle*, vol. 122, p. 1998.

[5] *The New York World*, Dec. 29, 1925, p. 1.

[6] Forgan, James B., "Branch Banking," *Sound Currency*, vol. IX, pp. 88, *et seq.*

CHARACTERISTICS OF THE BRANCH-BANKING BUSINESS IN NEW YORK AND THE POSITION OF THE NEW YORK BANKS IN THE BRANCH-BANKING CONTROVERSY

Branch banking in New York does not present the uniformity of characteristics which exists in the Michigan and California systems. In the main, this lack of uniformity is the result of the absence of savings accounts in the business of the banks engaged in branch banking. In New York, as in New England, the mutual savings banks, rather than the commercial banks, do the bulk of the savings-bank business, though some of the national banks with branches are trying to build up their "thrift accounts."[1]

Nevertheless, it is possible to make certain generalizations with regard to the prevailing situation. Branches may be regarded merely as agencies for the collection of deposits or largely as agencies for lending of funds or for a combination of these two functions. It is claimed that one or more of the leading banks in the branch-banking field use their branches largely for the purpose of obtaining deposits of money from people, such as school teachers, who merely wish the convenience of a checking account and the safety of the bank's care over funds temporarily in excess of current needs. The funds thus accumulated by the bank without the necessity of paying interest are loaned very largely on collateral security at call or invested in the safest securities, such as U. S. Government bonds.[2] While one or two banks with many branches may engage in this profitable and safe type of business, the majority of the banks are compelled to engage in real commercial banking with a considerable proportion of borrowing customers at the branches. Perhaps the Manufacturers Trust Company may be taken as the extreme example in this line. This "unit banking system," as it calls itself, maintains fifteen offices. These offices are given a considerable measure of independence, and local advisory committees are established to safeguard and facilitate the extension of loans to business men in the neighborhood of the branches. This bank is primarily a business man's bank and does not regularly lend

[1] *Cf.* pamphlets of Chatham Phenix National Bank and Trust Company.

[2] Interviews with leading New York bankers engaged in branch banking, verified by a study of published balance sheets of the banks.

money at call on the stock exchange.[1] Of course, most of the banks engaged in branch banking fall between these two extremes, establishing some of their branches primarily to collect deposits on checking accounts and other branches to assist in making loans to neighborhood merchants and business men and using temporarily surplus funds in call or short-time loans on stock-exchange collateral.

The great banks of the city, such as the Chase National Bank, which have thousands of correspondent banks and millions of dollars of bankers' balances, have been relatively slow in embarking upon branch-banking ventures within the city, though foreign branches have been established. However, the tendency shown by the Chase National Bank—Mechanics and Metals Bank merger, is for these large banks to acquire city branch-banking systems through merging with existing banks having such systems.[2]

Lack of Controversy.—The growth of branch banking has not aroused any noticeable opposition in New York.[3] The reason for this probably lies in the gradual nature of the growth and in the limitation of branch banking to the limits of cities in which parent banks are located. The New York banks as a group, at least, have manifested remarkably little concern about the course of national legislation affecting branch banking, though the New York Bankers Association adopted a resolution urging the passage of the McFadden National Bank Bill,[4] which, as finally passed in February, 1927,[5] legalized the practice of city branch banking conducted by national banks. The apparent neutrality of the great New York banks is easily explained. Among their thousands of bank correspondents are the most ardent advocates of branch banking as well as the most bitter opponents. Any departure from the strictest neutrality was certain to imperil friendly relationships with at least one of these groups. These city correspondent banks could not afford to take sides in such

[1] Interview with Nathaniel Mills, Manufacturers Trust Company.

[2] *Cf. supra*, p. 136.

[3] Personal interviews with prominent New York bankers in the summer of 1926.

[4] *The Commercial and Financial Chronicle*, June 26, 1926, vol. 122, p. 3549.

[5] *Infra*, pp. 178–179.

a contest. On the other hand, the strictly local New York banks could expect little practical effect from the branch-banking sections of the national measure under discussion. They were already establishing and operating local branches either under the state law or under the rulings of the Comptroller of the Currency, and if the national measure had not been passed legalizing the so-called "additional offices," authorized by the Comptroller, it would have been an easy matter for the national banks to convert into state institutions.

CHAPTER XII

BRANCH BANKING IN MASSACHUSETTS

THE LAW

Branch Offices.—By an act passed in 1902, trust companies were permitted to establish branch offices:

> The board of commissioners of savings banks may authorize in writing any trust company to maintain a branch office in the city or town in which its main office is located, for the sole purpose of receiving deposits, paying checks, and transacting a safe-deposit business.[1]

During 1903, the board authorized the Worcester Trust Company to maintain three offices; but in 1907, the Attorney General, having been asked by the bank commissioner whether the act permitted a trust company to maintain more than one branch office, replied that it did not.[2] An attempt was made to amend the act by insertion of the words "one or more branch offices" in place of "a branch office," but this failed of passage.[3]

Amendment.—In the 1907 report, the bank commissioner recommended that branches be allowed to lend as well as receive deposits and conduct a safe-deposit business, and he cited as evidence of the desirability of this change the general practice elsewhere and the success of a Boston branch of a Nova Scotia bank in particular.[4] The act was amended in accordance with this suggestion, permitting the branch to do a regular banking business and making specific the requirement that not more than one branch be permitted, with the provision that

> . . . the restrictions of this act shall not extend to branch offices authorized by the board of commissioners of savings banks, or by the bank commissioner prior to its passage.[5]

[1] Massachusetts, Acts of 1902, Ch. 355, Sec. 2.

[2] *Annual Report* of the Bank Commissioner of Massachusetts, 1907, p. xxxii.

[3] *Ibid.*, pp. xxxii–xxxiii.

[4] *Ibid.*, p. xxxiii.

[5] Massachusetts, Acts of 1908, Ch. 520, Sec. 15.

In 1914, an act was passed which permitted a trust company to maintain any office of a trust company, the business of which it had taken over by consolidation. This was restricted to banks, that is, trust companies, located in the same city or town and, further, by the provision, "if in the opinion of the bank commissioner, public convenience will be served thereby."[1]

THE DEVELOPMENT

Since the trust companies were restricted in the first instance to one branch each, no very great development could be expected.[2] By 1907, there were twelve branches. The number increased slowly to seventeen, in 1911, and rapidly from then until 1914, when there were thirty-one branches in the state, of which sixteen were in Boston. The growth from 1914 was gradual, one to four branches a year, reaching a total of forty-two in 1919. Six were added in 1920, and three the following year, making a total of fifty-one, of which twenty were in Boston. All but two of the Boston trust companies with branches were members of the Federal Reserve System. Of the twenty-four outside Boston, only nine were members.[3]

Consolidations.—By the familiar process of consolidation and conversion, trust companies acquired several branches and became national banks to continue the consolidation and acquiring of branches. By this method, three national banks built up the only branch-banking systems of much size in the state. These three banks were, on Dec. 31, 1925:[4]

	Both	Statutory branches	Additional offices
First National Bank of Boston	10	7	3
The Atlantic National Bank of Boston	5	3	2
Federal National Bank of Boston	5	4	1
	20	14	6

[1] Massachusetts, Acts of 1914, Ch. 504, Sec. 3.

[2] *Annual Reports* of the Bank Commissioner of Massachusetts, *passim.*

[3] *Cf. Annual Report* of the Federal Reserve Board, 1921, p. 240.

[4] *Report* of the Comptroller of the Currency, 1925, pp. 14–17.

There were thirteen other additional offices of national banks in the state besides three statutory branches. The trust companies in Boston have declined in number as a result of these consolidations, and the eight Federal Reserve member trust companies of Boston had only eleven branches in 1924.[1] With the exception of the Newton Trust Company and the Worcester Bank and Trust Company with five and three branches, respectively, the trust companies outside Boston had only one or two branches each at that date.

Trust Company Question.—In Massachusetts, therefore, the national bank question appears to have given place to the trust company question, for it is the state system which is declining as the result of branch banking, rather than the national. If it is desirable to have state and national banks on an equal competitive basis, the Comptroller of the Currency ought to allow national banks in Massachusetts to establish not more than one additional office, except as others might be gained through consolidation with other banks having branches or offices. However, this has not been the rule of the Comptroller's office, and by June, 1924, the national banks had thirty-one of the seventy-four branches of the state.[2] By December, 1925, the number of national bank branches had increased to thirty-seven out of eighty-eight for the whole state.[3]

BRANCHES OF SAVINGS BANKS IN MASSACHUSETTS

The provision for branches of savings banks contained in the law of 1908 was more liberal than that applicable to trust companies, since the law permits them to establish one or more branches, though for the receipt of deposits only, a limitation which would not be serious for a savings bank, "in the city or town in which its banking house is located, or in towns not more than fifteen miles distant therefrom in which there is no savings bank at the time."[4]

[1] Hearings, p. 37.
[2] *Federal Reserve Bull.*, December, 1924, p. 939.
[3] *Ibid.*, June, 1926, p. 408.
[4] Massachusetts, Acts of 1908, Ch. 590, Sec. 36.

Negligible Development.—The development under this law has been almost negligible.[1] There were 6 branches in 1908, 7 in 1911, the same in 1917, and only 9 in 1921, while there were 196 savings banks at the latter date, which represents, however, an increase of only 8 savings banks since 1908. As regards savings banks, the situation has been static rather than dynamic, and the probable passive reason for the lack of development of branch banking by the savings banks is the adequacy of the existing institutions to meet the demands for facilities. However, the active reason is that the savings banks as mutual institutions have nothing to gain by extending the scope of their operations to other communities either by establishing new branches or by acquiring banks already established. The contrast between this and the California situation has previously been referred to.[2]

[1] *Annual Reports* of the Bank Commissioner of Massachusetts, 1907–1921, *passim*.

[2] *Supra*, p. 99.

CHAPTER XIII

BRANCH BANKING IN NORTH CAROLINA

Special Acts.—In North Carolina, the practice of incorporating banks by special act of the state legislature continued until the beginning of the present century.[1] There was no provision of law dealing with the subject of branch banking, and some of these special charters contained sections permitting the establishment of branches or agencies.[2] However, in the absence of such permissive sections in the bank charter, the bank as a corporation had no legal power to establish a branch. Nevertheless, the state was not active in preventing the establishment of branches by banks which lacked the necessary authority.[3]

General Act.—The general act for incorporation of banks legalized the establishment of branches, stating that "no branch office or business may be established and maintained without the approval first obtained of the corporation commission."[4] Finally, in 1921, very exact provisions were set forth for obtaining the approval of the corporation commission.[5] Additional capital for each branch had to be provided. The required capital for a branch was graded according to the population of the place in which the branch was to be established and ranged from $20,000 for a town of a population of 3,000 or less up to a maximum of $100,000 for a city of more than 25,000 population.[6]

Slow Growth.—There was very little development of branch banking in North Carolina under the special charters. A bank chartered in 1872 had been given power to establish branches or

[1] *Cf.* Consolidated Statutes of North Carolina, 1919, vol. I, p. 67; also, 17 S. E. Rep. 156.

[2] 30 S. E Rep. 341, 342, Morehead Banking Company *vs.* Tate, May 24, 1898.

[3] *Ibid.*

[4] Consolidated Statutes of North Carolina, 1919, vol. I, p. 67.

[5] North Carolina B. L. 1921, Sec. 43.

[6] *Ibid.*

agencies at the will of the president and directors and had actually established four branches, all but one of which had been closed by 1893 when the bank failed.[1] Another bank, without charter power, had established an agency in 1890. A branch of the Cabarrus Savings Bank was established in 1899. Several other banks established branches in the following years, until, by the year 1909, there were twelve branches in the state, operated by seven parent banks. The Cabarrus Savings Bank (Concord, N. C.) had three branches in other small towns, and the Wachovia Bank and Trust Company had four branches outside its home town of Winston, N. C.[2] The slow growth of this early period continued in the following years. In 1913, there were only sixteen branches in the state. However, by 1920, the number of branches had increased to forty-five, at an average rate of growth of about four branches a year. By the end of 1923, there were fifty-eight branches,[3] and by Dec. 30, 1925, there were sixty-five branches of state banks and three branches of national banks.[4] While the growth of branch banking has been very slow, the growth in resources of state banks has been extremely rapid, nearly a tenfold increase in a ten-year period, being about $30,000,000 in 1915 and about $280,000,000 in 1924.[5]

From June, 1924, to December, 1925, the growth of branch banking in North Carolina almost ceased. While there was an increase of three in the number of branches, from sixty-six, in June, 1924, to sixty-nine, in December, 1925, there was a decrease in the number of banks operating branches from forty, at the earlier date, to thirty-nine, at the later.[6] By Dec. 31, 1926, the number of parent banks had increased once more to forty, and the number of branches had grown from sixty-nine to seventy-four.

There are two pronounced peculiarities in the development in North Carolina, the smallness of the systems and the country bank character of the movement. In 1924, only one bank had as

[1] 29 S. E. Rep. 776.

[2] *Reports* of the Condition of State Banks, Department of the North Carolina Corporation Commission, *passim.*

[3] *Ibid.*

[4] *Federal Reserve Bull.*, June, 1926, pp. 407–408.

[5] *Reports* of the Condition of State Banks, *passim.*

[6] *Federal Reserve Bull.*, June, 1926, p. 404, Table 5.

many as six branches; two banks had five branches each; four banks had three each; five had two each, and twenty-nine had just one branch each.[1] Only seven of the sixty-nine branches, in 1925, were located in the same city as the parent bank.[2] The similarity of this development to the early development in California, from 1890 to 1906, is very marked. It has been a slow growth of small country systems.[3] None of the large city banks has manifested a desire to build up a large system of country branches.

National Banks.—The development in North Carolina has been little affected by the national branch-banking controversy. There were 83 national banks in the state in 1924, and only 2 of them had branches. The resources of the national banks were about $178,000,000 as compared with about $280,000,000 of state bank resources. Nearly all of the state banks are small banks, and only 11 of the 471 state banks were members of the Federal Reserve System in 1924.[4] Through the withdrawal of two small banks not engaged in branch banking, the number was reduced to 9 by 1925.[5] Only 2 of these Federal Reserve member state banks are large banks. The Wachovia Bank and Trust Company, Winston-Salem, with five branches, had resources of more than $41,000,000 in 1925. The American Trust Company, Charlotte, which formerly operated one branch, but which does not now operate any branches, had resources of nearly $20,000,000.[6] Of the other state member banks, four operate branches, while three do not.

Opposition to the Federal Reserve System.—The lack of development of Federal Reserve membership among the state banks of North Carolina is the result of several factors. There exists a certain antipathy to federal institutions. This sentiment is stronger in country communities where many of the state banks are located. Many of the state banks are too small to meet the Federal Reserve Act requirements for membership in the system. However, the main obstacle to the extension of the

[1] *Reports* of the Condition of State Banks, 1924, *passim.*

[2] *Federal Reserve Bull.*, June, 1926, p. 408.

[3] *Supra*, pp. 30–31, 33–34.

[4] *Annual Report* of the Federal Reserve Board, 1924, p. 172.

[5] *Annual Report* of the Federal Reserve Board, 1925, p. 217.

[6] *Ibid.; cf.*, also, *Reports* of the Condition of State Banks, *passim.*

Federal Reserve System in North Carolina has been the attempt on the part of the Federal Reserve Board to establish a universal par-clearance system in the United States which has met with bitter opposition in North Carolina.[1] Under the rules of the Federal Reserve Board, the state banks would be compelled to give up the practice of making exchange charges on checks presented through the Federal Reserve Bank, if they became members of the Federal Reserve System.[2] Also, in the matter of reserves, the federal restrictions might lessen the profits of the banks, if they were to become members. Under the terms of the state law governing reserves, a state bank is required to keep a reserve in available funds to the amount of 15 per cent of its deposit liabilities payable on demand and 5 per cent of its time deposits.[3] Available funds are defined as cash on hand and balances due from other solvent banks.[4] On the other hand, a state bank which is a member of the Federal Reserve System complies with the Federal Reserve Act requirements as to reserve[5] and is compelled to keep all of the legal reserve of 13, 10, or 7 per cent of demand liabilities, (depending upon location in central reserve, reserve city, or outside) on deposit with the Federal Reserve Bank of the district.[6] The legal reserve against time deposits for Federal Reserve members of 3 per cent must also be kept with the Federal Reserve Bank entirely. However, though the Federal Reserve requirements are lower in percentage, the fact that the Federal Reserve banks do not pay interest on the balances carried with them, while other banks pay a customary 2 per cent on bankers' balances, makes Federal Reserve membership less attractive to these state banks which are permitted to carry as much of their reserve on deposit with other banks as they may find profitable. Moreover, a certain amount of till money is essential, in any case, and the federal law does not permit this to be counted as part of the legal reserve.

[1] *Annual Report* of the Federal Reserve Board, 1922, p. 31.

[2] *Ibid.*, 1924, Regulation J, Series of 1924, pp. 265–266.

[3] Consolidated Statutes of North Carolina, 1919, vol. I, p. 71.

[4] *Ibid.*

[5] *Ibid.*, p. 69.

[6] The Federal Reserve Act, Sec. 19, as amended by act approved Aug. 15, 1914 (38 Stat., 691, Ch. 252); act approved June 21, 1917 (40 Stat., Ch. 32).

Slight Effect of Federal Action.—In view of the extremely small number of state banks in the Federal Reserve System, it is apparent that the rules of the Federal Reserve Board, which were established in 1923, prohibiting, as a general rule, the free establishment of branches of state member banks except in the home city or contiguous territory[1] had very little, if any, effect on branch banking in North Carolina. For the same reason, the McFadden Act may be expected to have slight if any effect in checking the growth of branch banking in this state.[2]

[1] *Federal Reserve Bull.*, December, 1924, p. 928.
[2] *Infra*, p. 178.

PART IV
THE NATIONAL SITUATION

CHAPTER XIV

ADDITIONAL OFFICES OF NATIONAL BANKS

Recommendations of the Comptroller.—In 1920, the Comptroller of the Currency had recommended to Congress that

> . . . national banks, with the approval of the Comptroller of the Currency, shall be allowed to establish and maintain branches within certain limits, for example, within city or county lines, but not without the boundaries of the State in which the parent bank may be located . . .

to the maximum of twelve branches for a single bank and under suitable conditions as regards increase of capital.[1] Similar recommendations had previously been made by the Federal Reserve Board.[2] They had included, however, the proviso that this privilege should extend only to those national banks which were located in states which gave like privileges to state institutions. In fact, a bill embodying these provisions was introduced in the House of Representatives as early as 1918.[3] In 1919, a bill providing that a national bank might establish not more than ten branches within the corporate limits of a city of not less than 500,000 population was actually passed by the Senate.[4]

Administrative Action.—Nevertheless, the repeated recommendations of the Comptroller and of the Federal Reserve Board brought about no effective legislative relief. D. R. Crissinger became Comptroller of the Currency on Mar. 17, 1921, and when he found that no legislative relief was forthcoming, he decided upon an administrative measure. Mr. Crissinger was a lawyer and, from a careful study of the law relating to national banks, he came to the conclusion that the law did not prohibit the

[1] *Report* of the Comptroller of the Currency, 1920, vol. I, p. 65.

[2] *Annual Report* of the Federal Reserve Board, 1918, pp. 81, 83.

[3] *Ibid.*

[4] *Ibid.*, 1919, p. 528.

establishment of additional local offices of limited function by national banks.[1] Beginning with June 13, 1922, he began to issue permits to national banks to establish "additional offices" in the same city in which the parent bank was located, and from that time until Apr. 30, 1923, when he retired from office to become governor of the Federal Reserve Board, he issued ninety-seven such permits to national banks in various cities.[2]

Daugherty's Opinion.—The issuance of these permits for additional offices was continued in the administration of the next Comptroller, Henry M. Dawes. Mr. Dawes submitted the question of the legality of these permits to Attorney General Harry M. Daugherty. Mr. Daugherty's opinion, given Oct. 3, 1923, upheld the right of national banks to establish such agencies, on the ground that they were not branches which were clearly prohibited by the national law but mere agencies, being limited to routine work of receiving and paying deposits, and that they were positively permitted by Section 5136 R. S., which empowers national banks to exercise all such incidental powers "as shall be necessary to carry on the business of banking."[3] The final legality of these permits has not been tested by court action and therefore remains somewhat uncertain.[4]

BRANCHES OF NATIONAL BANKS, 1921–1926

Statutory Branches.—During the period from 1921 to 1926, the number of statutory branches of national banks increased appreciably. In the main, this increase took place under the provisions of the Consolidation Act of 1918 rather than through conversions of state institutions under the Act of 1865.[5] By direct conversion under the latter act, the number of banks and branches had increased only from 12 banks with 44 branches, in 1921, to 15 banks with 46 branches, in 1926, while the banks taking advantage of the Act of 1918, in the same time had increased from five with 23 branches to 22 with 121 branches.

[1] *Report* of the Comptroller of the Currency, 1922, p. 4.

[2] Collins, "The Branch Banking Question," p. 53; *Report* of the Comptroller of the Currency, 1922, p. 85; 1923, pp. 88–89.

[3] Collins, "The Branch Banking Question," pp. 53–54; Appendix A.

[4] *Infra*, pp. 165, 183.

[5] *Supra*, p. 12.

Two of these 463 branches were obtained through conversion under the Act of 1865.[1]

In California, only one bank, and that a small one, had taken advantage of either of these laws prior to the year 1926, when a Los Angeles national bank acquired 31 branches through a consolidation.[2] In 1921, 44 of the 67 statutory branches of the whole country were in New York City. By 1926, the number in New York City had increased only to 61, while the total for the country had become 167. In Massachusetts, there were no statutory branches of national banks in 1921; but by the end of 1926, there were 19. One Michigan bank with 9 branches had appeared in the list. No Ohio national banks had statutory branches in 1926, though state bank branches were numerous. The following table shows the geographical distribution of the national banks with statutory branches:

[1] *Report* of the Comptroller of the Currency, 1926, pp. 13–15; 1921, pp. 107–109.

[2] *Ibid.*, 1926, p. 14.

DISTRIBUTION OF NATIONAL BANKS WITH STATUTORY BRANCHES, OCT. 31, 1926[1]

State	National banks having branches acquired				Total	
	Through conversion		Through consolidation			
	Banks	Branches	Banks	Branches	Banks	Branches
California	1	3	2	32	3	35
District of Columbia	..	...	1	4	1	4
Georgia	..	...	2	6	2	6
Louisiana	1	8	..	...	1	8
Massachusetts	2	5[2]	3	14	5	19
Michigan	2	2	1	9	3	11
Mississippi	1	1	..	...	1	1
New Jersey	..	...	1	2	1	2
New York	3	20[2]	5	42	8	62
North Carolina	2	2	..	...	2	2
Oregon	1	1	..	...	1	1
South Carolina	..	...	2	7	2	7
Tennessee	..	...	1	1	1	1
Virginia	..	...	4	4	4	4
Washington	1	2	..	...	1	2
Wisconsin	1	2	..	...	1	2
Totals	15	46	22	121	37	167

[1] *Report* of the Comptroller of the Currency, 1926, pp. 13–15.

[2] One branch acquired through consolidation under the Act of 1918.

Additional Offices.—While this comparatively small increase in the number of statutory branches had been taking place, there had been a very considerable development of branch banking through the power to establish "additional offices." The Comptroller of the Currency began issuing permits for additional offices on June 13, 1922, and by Oct. 31 of that year he had issued fifty-one permits. More than 90 new offices were authorized in the year 1924 alone, and by the end of October, 1926, there were 298 of these additional offices.[1]

While the first additional offices were authorized for a national bank in Los Angeles and the subsequent development there was important, with 6 banks and 49 offices operating in 1926, the development in New York City has been far greater. By 1926 there were 20 national banks having a total of 80 additional offices in the city of New York. One national bank in Detroit had 21 offices, and in Philadelphia 12 national banks had a total of 18 offices. In all, there were 120 national banks and 298 additional offices located in fourteen states and the District of Columbia. The distribution is shown in the following table:

NATIONAL BANKS AND ADDITIONAL OFFICES, OCT. 31, 1926[1]

State	Banks	Offices	State	Banks	Offices
California	15	60	Nebraska	2	2
District of Columbia	4	5	New York	29	98
Georgia	2	2	North Carolina	2	2
Kentucky	3	7	Ohio	5	7
Maine	1	1	Pennsylvania	20	32
Maryland	4	6	Tennessee	5	8
Massachusetts	16	31	Virginia	4	9
Michigan	8	28	Total fourteen states and District of Columbia	120	298

[1] *Ibid.*, 1926, pp. 15–18, computations by the writer.

[1] *Reports* of the Comptroller of the Currency, 1921–1926, *passim*.

TABULAR SUMMARY

NATIONAL BANKS WITH BRANCHES AND ADDITIONAL OFFICES, OCT. 31, 1926[1]

State	All		Statutory branches		Additional offices	
	Banks[2]	Branches and offices	Banks	Branches	Banks	Offices
New York	33	160	8	62	29	98
California	17	95	3	35	15	60
Massachusetts	17	50	5	19	16	31
Michigan	11	39	3	11	8	28
Pennsylvania	20	32	..	...	20	32
Virginia	8	13	4	4	4	9
Fifteen other states and the District of Columbia[3]	40	76	14	36	28	40
Totals	146	465	37	167	120	298

[1] *Report* of the Comptroller of the Currency, 1926, pp. 13–18. Compiled.

[2] The number of parent banks does not include duplications. Four New York banks, four Massachusetts banks, one North Carolina bank, one Georgia, and one California bank were operating both statutory branches and additional offices.

[3] The number of branches per state graded down from nine to one.

More than half of the national bank branches and offices were in New York and California, and more than five-sixths were in the six leading states given in the table above. Again, more than half of the branches and offices were in five cities: 131 in New York, 73 in Los Angeles, 32 in Boston, 23 in Detroit, and 18 in Philadelphia, a total of 277 out of 465 for the whole country. On the other hand, a few large cities having numerous state bank branches had no national bank branches. Among these were San Francisco and New Orleans. There were only four national bank additional offices and no branches in Cleveland. Thus, it is clear that many national banks, faced with the competition of state bank branches, had not felt the necessity of taking advantage of the permission of the Comptroller to establish additional offices or acquire branches through consolidation with state institutions.

CHAPTER XV

RESTRICTIVE REGULATIONS OF THE FEDERAL RESERVE BOARD

THE FEDERAL RESERVE BOARD ACTS TO PROTECT NATIONAL BANKS FROM BRANCH-BANK COMPETITION

Recommendations.—The Federal Reserve Board had recommended to Congress as early as 1915 that national banks be granted the right to establish city branches and early in 1916 prepared a draft of an amendment to the Federal Reserve Act, which would have permitted national banks, under certain conditions, to establish local branches.[1] This was adopted by the Senate, Aug. 16, 1916, but did not prove acceptable to the House conferees. In 1918, the board renewed its previous recommendations to no avail, and in 1919 it commented on a Senate bill which would have permitted national bank branches in cities of 500,000 population, allowing a national bank to have not more than ten branches, and requiring that a bank, to take advantage of the permission, must have a capital and surplus of at least $1,000,000.[2] The board wished to have a lower population limit but preferred even this high limit to no action at all.[3] The branches would have been limited to states where state banks were accorded similar privileges.

Again, in 1922, the board recommended that action be taken by Congress: "An amendment to the national banking act allowing national banks the same privilege given to State banks in States where branch banking is permitted is much to be desired."[4] This recommendation went further than the earlier proposals in that it suggested the possibility of state-wide branch banking both for the purpose of meeting the competition of state-wide

[1] *Annual Report* of the Federal Reserve Board, 1915, p. 22.

[2] *Ibid.*, 1918, p. 83, 1919, p. 64.

[3] *Ibid.*, p. 65.

[4] *Ibid.*, 1922, p. 5

branch-banking systems, as in California, and for the purpose of remedying defects in the present system of providing credit in country communities through small independent banks. To support this recommendation, the board cited the finding of the Joint Commission of Agricultural Inquiry that "a system of limited branch banking might furnish a possible solution of this problem."[1]

Administrative Action.—When no legislation bringing about the desired reform proved to be forthcoming, the situation had reached such an acute stage in 1923 that the board decided upon administrative action. Inasmuch as the board had no power to grant further privileges to the national banks in the matter of establishing branches, its only recourse was to place some form of restriction on the branch-banking activities of the state bank members of the Federal Reserve System.

Previous Policy.—

> In general, it may be observed that prior to November, 1923, the board permitted expansion of member bank branch systems under State supervision and control, in so far as such expansion was consistent with sound banking principles of efficient administration, adequate State supervision, and complete solvency.[2]

In the 1923 report the following statement appears:

> The Board has called attention in previous reports to the growth of branch banking in some portions of the country. In the State of California the development has been rapid and continuous in recent years. The growth of branch banking presents a problem which is receiving the serious attention of the Board, with a view of finding a satisfactory method of dealing with the situation. The difficulties of the problem arise in part from the differences in the legislation in the various States and the competitive disadvantages suffered by national banks in States that permit branch banking. The Board is hopeful that it can by administrative measures find some reasonable method of harmonizing existing differences of interest of State and national banks in the matter of branch banking, and thus lay the basis for a policy which will result in shaping the development and practice of branch banking in the United States along useful and serviceable lines.[3]

[1] *Ibid.*, pp. 5–6.

[2] *Federal Reserve Bull.*, December, 1924, p. 926.

[3] *Annual Report* of the Federal Reserve Board, 1923, p. 48.

Resolutions of Nov. 7, 1923.—On Nov. 7, 1923, the board adopted certain resolutions restricting the activities of state bank members in the matter of branch banking, specifically on the ground of the competitive disadvantage under which the national banks were placed. These resolutions, in brief, enunciated certain general principles, by which the board announced that it would be guided on and after Feb. 1, 1924; that banks applying for membership would be required to give up any branches situated outside the home city and beyond the limits of towns whose corporate boundaries touched that of the home city; and, further, that present members would not be permitted to establish branches beyond these limits.[1] As these resolutions were adopted, no exceptions were provided for. The resolutions, however, were reconsidered on Mar. 27, 1924, and Apr. 7, 1924, and the stringency of the rules was greatly lessened by the adoption of a provision that exceptions might be made "where the State banking authorities have certified, and the board finds that public necessity and advantage render a departure from the principle necessary and desirable."[2] At the same time, other rules were adopted which were designed not to prevent branch banking but to safeguard its practice. In brief, these rules provided that the board would not grant a permit for any branch unless the state authorities made regular, simultaneous, and satisfactory examinations of the bank and all its branches; that each bank would be required to maintain adequate capital and an adequate percentage of "eligible" paper; that a recommendation would be required from the state authorities and a report and recommendation from the Federal Reserve Bank of the district before the board would consider any application; that unused permits would expire in six months· and that the board reserved the right to cancel any permit

> . . . whenever it shall appear, after hearing, that such branch agency or additional office is being operated in a manner contrary to the interest of the public in the locality in which it is established.[3]

These rules were made a part of Regulation H, which governs the membership of state banks and trust companies in the Federal

[1] *Federal Reserve Bull.*, December, 1924, p. 928.

[2] *Ibid.*, p. 929.

[3] *Annual Report* of the Federal Reserve Board, 1924, p. 261.

Reserve System.[1] A further change in this regulation was made by inserting the following section:[2]

Such bank or trust company, except after applying for and receiving the permission of the Federal Reserve Board, shall not consolidate with or absorb or purchase the assets of any other bank or branch bank for the purpose of operating such bank or branch bank as a branch of the applying bank; nor directly or indirectly, through affiliated corporations or otherwise, acquire an interest in another bank in excess of 20 per cent of the capital stock of such other bank; nor directly or indirectly promote the establishment of any new bank for the purpose of acquiring such interest in it; nor make any arrangement to acquire such an interest.

EFFECTS OF THESE RULINGS OF THE FEDERAL RESERVE BOARD

It is not easy to indicate precisely the effect of these rulings, since they constituted only one of several factors in the situation. The only important application of the rules was to the Federal Reserve member banks in California, since the branches were already restricted by state laws to cities or contiguous territory in all of the other states where Federal Reserve members have engaged in branch banking to an appreciable extent. The practical effect of this ruling was to check the intercommunity branch-banking development in California, for the Federal Reserve Board adhered strictly to the rule.[3]

The regulation, however, was necessarily limited in its direct effect to banks which were members of the Federal Reserve System. This limitation had an important bearing on the course of the subsequent development. As in the earlier period of California branch banking,[4] so in this, the Bank of Italy has followed an extremely aggressive policy. The Bank of Italy, as a Federal Reserve member, found its expansion checked, but the Liberty

[1] *Annual Report* of the Federal Reserve Board, 1924, pp. 258–262, Regulation H, Series of 1924 (superseding Regulation H of 1923). The rules are embodied in Sec. VI.

[2] *Ibid.*, Sec. IV, dealing with conditions of membership, par. 5.

[3] Letter from California State Banking Department, Mar. 10, 1926; "In passing upon applications by state bank members, in California, the Federal Reserve Board has adhered strictly to its contiguous territory rule. In addition branch banking in the State of California seems to have reached the stage where expansion is necessarily slower."

[4] *Supra*, pp. 58–59.

Bank in San Francisco and the Bank of America in Los Angeles, non-member banks, practically owned by the Bank of Italy, continued the expansion of the branch system rapidly, subject only to the restraint imposed by the superintendent of banks.[1] Moreover, the Bank of Italy also controlled the Commercial National Trust and Savings Bank in Los Angeles, which was permitted by the Comptroller of the Currency to establish numerous additional offices in Los Angeles.[2] Thus, through stock ownership and a system of holding companies, the Bank of Italy was building up a state-wide organization despite checks imposed by both federal and state authorities.

THE EMERGENCE OF THE BANK OF ITALY NATIONAL TRUST AND SAVINGS ASSOCIATION

Matters moved with dramatic swiftness in the first two months of the year 1927. It appeared that with the loss of the *de novo* case the Bank of Italy's further expansion was likely to be small. Nothing could have been farther from the truth. The superintendent of banks (who holds office at the "pleasure of the governor")[3] Mr. Johnson, was replaced by Will C. Wood, whose first official action was to sanction the consolidation or merger of the Liberty Bank of San Francisco with 32 branches, the Commercial National Trust and Savings Bank of Los Angeles with 23 branches, the Bank of America of Los Angeles with 22 branches, and the Southern Trust and Commerce Bank of San Diego with 8 branches into the Liberty Bank of America.[4] All of these banks had been affiliations of the Bank of Italy. This consolidation took place on Jan. 28, 1927. The new bank had 136 branches in all, obtained through the purchase of individual units in addition to the merging banks. Moreover, the new superintendent departed from the *de novo* rule of his predecessors and authorized the new bank to establish 8 new branches in Los Angeles and 4 in Oakland.[5]

The details of this merger had barely been announced when the amalgamation of the Bank of Italy and the newly created Liberty

[1] *Cf. de novo* case, *supra*, pp. 81–85.

[2] *Report* of the Comptroller of the Currency, 1925, p. 16.

[3] The California Bank Act, Sec. 120.

[4] *The Commercial and Financial Chronicle*, Feb. 5, 1927, vol. 124, p. 748.

[5] *Ibid.*, Feb. 12, 1927, p. 880.

Bank of America took place with the consent of both the state superintendent of banks and the Federal Reserve Board.[1] This sanction of such an amalgamation is justified by the superintendent in the following words:

> In deciding to approve the agreement of purchase and sale, I took into consideration the fact that both the Bank of Italy and the Liberty Bank of America are now owned by the same people and are all but technically under the same general management. Bankers generally are agreed that it is neither good banking policy nor good public policy to keep banks separate in operation when the ownership is practically identical.[1]

The Bank of Italy thus became the largest bank in the United States outside New York, with a system of branches, 276 in number, extending all over California, with a capitalization of $105,000,000 and resources of nearly $650,000,000. It made application to become a national bank and, with the consent of the Comptroller of the Currency and the Federal Reserve Board, became, as of Mar. 1, 1927, the Bank of Italy National Trust and Savings Association.[2] The comparative size of the Bank of Italy National Trust and Savings Association is indicated by the fact that the resources of all of the national banks in California was only about $1,000,000,000 in 1925.[3]

Unquestionably, the reason for the rapidity of this development lay in the desire, under favorable state conditions, to build up a complete state system of branches before the McFadden Bill was enacted with its prohibition to national banks and state bank members of the Federal Reserve System of any new out-of-the-city branches after the date of the passage of the act.[4] This act was approved on Feb. 25, 1927,[5] and it would appear that the Bank of Italy has now reached its final form under present legislative restrictions. No new state legislation affecting branch banking has been passed recently, in California.

[1] *Ibid.*, Feb. 26, 1927, p. 1177.

[2] *Ibid.*, Mar. 5, 1927, p. 1308.

[3] *Supra*, p. 88.

[4] *Cf.* appendix, text of act, Sec. 9.

[5] *The Commercial and Financial Chronicle*, Feb. 26, 1927, p. 1161.

CHAPTER XVI

THE McFADDEN NATIONAL BANK ACT

Opposition to Branch Banking.—The discussion preceding this chapter has shown the need of action to protect the interests of the national banks and also the general nature of the relief proposed by the Comptroller of the Currency and by the Federal Reserve Board. It was not until February, 1927, that Congress granted the legislative relief sought. While the national administrative officials were seeking to improve the competitive position of the national banks confronted with branch-bank competition of state banks, great groups of bankers strongly opposed to branch banking were very active in preventing the passage of legislation which had the slightest appearance of favoring branch banking in any form. The American Bankers Association is the customary agency for the expression of the majority views of the bankers of the country, but the animosity against branch banking had become so great by the years 1921 and 1922 that the opponents of branch banking formed a national Association Opposed to Branch Banking with headquarters at Chicago.[1] Also, various state organizations to aid in the fight within state limits were formed. One of these, the Missouri Association Opposed to Branch Banking, had as many as 1,300 members in 1924.[2] The Chicago and Cook County Bankers Association took a very active part in the fight against branch banking.[3]

Chicago Group.—There are several reasons for the position of the Chicago bankers as the leaders in the movement against branch banking. The Middle West is the section of the country which has the least amount of branch banking. The unit bankers

[1] Collins, "The Branch Banking Question," pp. 22–23.

[2] *The Independent Banker*, Mar. 1, 1924, p. 1.

[3] *Cf. The Commercial and Financial Chronicle*, May 1, 1926, pp. 2442–2443. "Chicago and Cook County Bankers Association Views McFadden Banking Bill as Amended by Senate Committee as Fraught with Grave Danger."

are, therefore, by far the predominant element in the banking of that section. Moreover, Chicago, as the largest city and the financial center of that region, enjoys a general position of leadership. There were 173 so-called "outlying banks" in Chicago in 1924.[1] These relatively small suburban banks have been bitter in their opposition to branch banking, since they share a common fear that the spread of branch banking means the elimination of the small bank, especially in the large cities. To support this view was the fact that there were, indeed, few small banks in Los Angeles, San Francisco, Detroit, and New York. While the outlying banks of Chicago are thus strong in their opposition to branch banking, the "loop banks," that is, the large banks of the financial center, finding that they have been successful under the present regime of unit banking, are willing to continue "the game under present rules," though they do not appear to be fearful of branch banking.[2] Moreover, these loop bankers contend that branch banking is not needed in Chicago to preserve the stability of banking, since the small banks are conservatively managed and receive such supervision from the clearing house that failures are unknown.[2] Since these outlying banks carry substantial balances with the loop banks, turn over profitable business to them, and are less bother than branches would be, the loop banks also tend to oppose branch banking.

First National Bank in St. Louis vs. State of Missouri.—The smouldering opposition of these groups was brought to an intense flame by the action of the First National Bank in St. Louis, which, without the approval of the Comptroller of the Currency, established a branch in the city of St. Louis, on June 15, 1922, and announced that it intended to establish other branches.[3] This action was in defiance of a statute of the state of Missouri which prohibited any bank from maintaining a branch in the state.[4] The state authorities brought suit against the bank in

[1] Baty, E. N., "The Story of the Outlying Banks of Chicago," p. 5.

[2] Personal interviews with several Chicago bankers, August, 1926.

[3] 263 U. S. 655, First National Bank in St. Louis *vs.* State of Missouri, decided Jan. 28, 1924.

[4] Section 11,737, Revised Statutes, Missouri, 1919.

the state Supreme Court. There was no question of fact in the case. The bank admitted that it was conducting a branch. It denied, however, that the state authorities had any power to institute proceedings against it as a national institution and further claimed that its charter gave it power to establish the branch in question.[1] The Supreme Court of the state rendered a decision adverse to the bank's contentions, and when the case was carried to the United States Supreme Court, the decision of the state court was affirmed.[2] It was thus definitely settled that the national banks had no legal power to establish branches and that state laws forbidding branch banking might be enforced against national banks. The case was not finally decided until Jan. 28, 1924 and while it was pending, the bankers of the Middle West became convinced of the nearness of the branch-banking "danger." In the trial of the case, there was an "imposing array of counsel on each side, numbering, in all, thirty," representing ten states and various organizations.[3]

Unorganized Defense of Branch Banking.—In contrast to the organized opposition to branch banking is the unorganized character of the defense of branch banking. The few California big branch banks have been actively engaged not so much in getting legislation favorable to branch banking as in preventing the passage of unfavorable legislation.[4] The national banks in cities where state banks have branches have not formed state or national organizations to fight for their interests. They have merely acted through the national bank division of the American Bankers Association where they are greatly outnumbered by the small country national banks. At the 1921 meeting of the association, the national bank division adopted a resolution condemning branch banking in general but asking Congress to amend the National Bank Act so as to allow national banks to have branches in cities where the state banks were authorized to maintain branches under state laws.[5]

[1] 263 U. S. 641, 642.

[2] 263 U. S. 661; 297 Mo. 397.

[3] Collins, "The Branch Banking Question," p. 61.

[4] *Supra*, pp. 73, 78, 79.

[5] *Journal of the American Bankers Association*, November, 1921, p. 405.

THE McFADDEN NATIONAL BANK BILL

Origin.—In the summer of 1923, the Comptroller of the Currency, Henry M. Dawes, requested his associates in the bureau to submit to him modifications in the national banking laws which they thought would be desirable.[1] As a result of this request, suggestions were received from the examiners and from bankers whom the examiners questioned as to desired changes. These suggestions were digested by the bureau and submitted to the bankers "in a very general way."[1] Finally, in the latter part of 1923, Charles W. Collins, deputy comptroller, put the proposals into legislative form for presentation to Congress. After further revising the draft, the bureau submitted it to the Banking and Currency Committees of the House and Senate.[2] Almost identical bills were reported out in House and Senate.[3]

Main Features.—Besides a number of matters of seeming minor importance, the proposed legislation touched upon five subjects of primary significance to the national banks. The first of these was branch banking.[4] About the branch-banking provisions of the bill much dispute arose.[5] Other provisions aroused very little protest either in or out of Congress.[6] The second important provision was the granting of indeterminate charters to national banks in place of the ninety-nine-year charters then permitted.[7] Such indeterminate charters would be of assistance to the banks in carrying on a trust business, especially. Third, in order to lessen the demand for branch banks and for small state banks, provision was to be made for the issuance of charters to national banks with only $100,000 capital to operate in outlying districts of cities of over 50,000 population.[8] Fourth, national banks were to be allowed to make loans on city real estate for a period of five years instead of one year and to an aggregate

[1] Collins, "The Branch Banking Question," pp. 82–83; *Report* of the Comptroller of the Currency, 1924, p. 2–12.

[2] *Report* of the Comptroller of the Currency, 1924, p. 2.

[3] *Ibid.*, p. 3 (H. R. 8887, S. 3316).

[4] *Ibid.*, pp. 3–6.

[5] *Ibid.*, p. 3.

[6] *Ibid.*, 1925, pp. 2–3.

[7] *Ibid.*, 1924, p. 6.

[8] *Ibid.*, p. 7.

amount of not more than 50 per cent of their time deposits.[1] Fifth, the national banks were to be allowed to deal in securities.[2] This permission to deal in securities constitutes a legalization of the prevailing practice rather than an entirely new grant of power.[3]

Congressional Deadlock.—The McFadden Bill passed through several metamorphoses, having been introduced in four successive sessions of Congress before it became a law in February, 1927. A lack of agreement on the part of the House and the Senate with regard to the branch-banking provisions had prevented the passage of the bill in the earlier sessions of Congress. The House position had been extremely unfavorable to branch banking, while the Senate had shown a willingness to allow appreciable latitude in the matter of branch-banking development.

The Hull Amendments.—The original bill, so far as it applied to the subject of branch banking, simply provided that state bank members of the Federal Reserve System might not establish branches outside their home cities and that national banks might establish branches in their home cities in those states where state banks were accorded a like privilege.[4] All of the discussion in the hearings before House and Senate committees centered around these branch-banking provisions. A group of California bankers engaged in branch banking, representatives of the California banking department, Vice-governor Platt, Governor Crissinger of the Federal Reserve Board, and others appeared before the committees in opposition to the proposed restrictions on state bank members of the Federal Reserve System.[5] Comptroller of the Currency Henry M. Dawes and a group from the California League of Independent Bankers were most active in favoring the restrictions. After the hearings in the spring of 1924, the Chicago bankers, on May 15, suggested certain amendments to the bill which would

> . . . limit branch banking to those States which permitted branch banking at the time of the approval of the bill—so far as the national banking and the Federal Reserve Systems are concerned.[6]

[1] *Ibid.*, p. 11.
[2] *Ibid.*, p. 12.
[3] *Report* of the Comptroller of the Currency, 1924, p. 12.
[4] Collins, *op. cit.*, pp. 83–84.
[5] Hearings, *passim.*
[6] Collins, "The Branch Banking Question," p. 93.

The theory upon which these these proposals were founded was that the powerful banking interests in the large cities, being practically all national or State member banks, would be deprived of any motive to seek branch banking legislation from the State legislatures . . . The principle thus advocated became embodied in what have become known as the Hull amendments. They were prepared by Congressman Morton D. Hull of Chicago but were not introduced until the next session of the Sixty-eighth Congress.[1]

On May 28, the National Association of Supervisors of State Banks filed a protest with Chairman McFadden demanding protection for the state banks from the exercise of supervision over them by the Federal Reserve Board such as was embodied in Regulation H.[2] No vote was reached in either House or Senate, although in both houses of Congress the bills were in a privileged position at the end of the session.[3]

With the Hull amendments, the McFadden Bill was hailed by the American Bankers Association, assembled at Chicago in October, 1924, as a happy solution of the branch-banking problem.[4] The national Association Opposed to Branch Banking was absorbed by the American Bankers Association to become the branch-banking committee of the latter.[5]

The bill was finally passed by the House in the second session of the Sixty-eighth Congress, but the Senate Committee eliminated the Hull amendments as well as Section 9 of the proposed measure. Section 9 was designed to prevent state member banks from establishing new out-of-the-city branches at any time after the passage of the act.[6] In the press of business, however at the

[1] *Ibid.*, p. 94. [2] *Ibid.*, p. 95. [3] *Ibid.*, p. 96.

[4] *Ibid.*, p. 97; *cf.* also *Journal of the American Bankers Association*, October, 1924, p. 191.

[5] Collins, "The Branch Banking Question," p. 97.

[6] Hearings, p. 3. "Sec. 9. That section 9 of the Federal reserve act paragraph 1 thereof, be amended by adding at the end thereof the following language: '*Provided*, that on and after the approval of this act the board shall not permit any such applying bank to become a stockholder of such Federal reserve bank except on condition that such applying bank relinquish any branches which it may have established on or after the above-mentioned date beyond the corporate limits of the municipality in which the parent bank is located; *Provided further*, that no member bank shall, after the approval of this act, be permitted to establish a branch beyond the corporate limits of the municipality in which such bank is located.' "

end of the session, the Senate again failed to come to a vote on the measure.[1]

In the late fall of 1925, a referendum of the United States Chamber of Commerce was held, and the replies from 1,400 business organizations indicated a preponderant sentiment in the business community favoring the general principles of the McFadden Bill, namely, that national banks be permitted to have city branches in those states where the state banks are accorded a like privilege, that the national banks be given indeterminate charters, that they be given power to deal in investment securities, and that the national banks be permitted to lend on mortgages on city real estate with a maturity up to five years instead of one, as formerly.[2]

Bill in the Sixty-ninth Congress.—At the opening of the first session of the Sixty-ninth Congress, in December, 1925, Representative McFadden reintroduced the bill (now called "H. R. 2.") in the same form as previously passed by the House.[3] On Feb. 4, 1926, the bill again passed the House by a large majority.[4] Senators Pepper, Glass, and Edge, as a subcommittee of the Senate Committee on Banking and Currency held hearings on the bill, Feb. 16, 17, 18, and 24, 1926, and on Mar. 12, 1926, the bill was reported to the Senate with the controversial branch-banking sections so altered as to permit state member banks to establish branches in "contiguous territory" as well as within the corporate limits of the city of the parent bank. A like privilege was to be accorded to national banks in those states permitting state banks to establish branches.[5] Senator Glass led the fight against the restrictions on branch-banking activities of members of the Federal Reserve System, claiming that the restrictions proposed in the House measure would tend to destroy the national bank system and to drive state banks out of the Federal Reserve System.[6]

[1] Collins, *op. cit.*, pp. 101, 105.

[2] *The Commercial and Financial Chronicle*, vol. 120, p. 2224; vol. 121, p. 2821.

[3] *Ibid.*, vol. 121, p. 2821.

[4] *Ibid.*, American Bankers' Convention Section, Oct. 16, 1926, p. 88.

[5] *Ibid.*, vol. 122, pp. 1704–1706.

[6] *Ibid.*, vol. 122, p. 1397 (Mar. 13, 1926).

Changes Made by Senate Committee.—The Senate Committee added an entirely new section to the bill. This was Section 20, providing indeterminate or perpetual charters for the Federal Reserve Banks.[1]

After the changes made by the Senate Committee, the sections of the bill relating to branch banking were as follows:[2]

Sec. 7. That Section 5155 of the Revised Statutes of the United States be amended to read as follows:

"Sec. 5155. The conditions upon which a national banking association may retain or establish and operate a branch or branches are the following:

(*a*) A national banking association may maintain and operate such branch or branches as it may have in operation at the date of the approval of this Act.

(*b*) If a State bank is hereafter converted into or consolidated with a national banking association, the said association may retain and operate such branches if any, as were being maintained and operated by said State bank at the date of the approval of this Act.

(*c*) A national banking association may, after the date of the approval of this Act, establish and operate new branches within the limits of the city, town, or village in which said association is situated if such establishment and operation are at the time permitted to State banks by the law of the State in question.

(*d*) If at the date of the approval of this Act there is situated in any State which prohibits branches a national banking association which has one or more branches within the city in which the parent bank is located, any other national bank situated in such city may establish within the limits of such city branches not exceeding in number the aggregate number of branches maintained by such national banking association.

(*e*) No branch shall be established after the date of the approval of this Act within the limits of any city, town, or village of which the population by the last decennial census was less than 25,000. No more than one such branch may be thus established when the population, so determined, of such municipal unit does not exceed 50,000 and not more

[1] *Ibid.*, p. 1547. "Sec. 20. That the second subdivision of the fourth paragraph of Section 4 of the Federal Reserve Act be amended to read as follows:

'Second. To have succession after the approval of this Act until dissolved by Act of Congress or until forfeiture of franchise for violation of law.' "

[2] *Ibid.*, Mar. 27, 1926, vol. 122, pp. 1704–1706.

than two such branches where the population does not exceed 100,000. In any such municipal unit where the population exceeds 100,000 the determination of the number of branches shall be within the discretion of the Comptroller of the Currency.

(*f*) In cases in which, under the provisions of this section, a national banking association is authorized to establish a branch or branches within the limits of a city, town, or village, the Comptroller of the Currency shall have the discretionary power to authorize the establishment and operation of such branch or branches beyond the boundaries of said city, town, or village as strictly defined by law, but only within the same metropolitan area as that in which the parent bank is situated; Provided, however, that he shall in no case authorize such establishment and operation except within the territory of a city, town, or village the corporate limits of which at some point coincide with the corporate limits of the city or town in which the parent bank is situated, when in his discretion he shall determine, after public hearing, that the banking needs of the inhabitants of said contiguous and urban territory require the establishment of such branch or branches but no branch shall be established under the authority of this section in any part of a State to which right of State banks, under the State law, to establish branches does not extend.

(*g*) No branch of any national banking association shall be established or moved from one location to another without first obtaining the consent and approval of the Comptroller of the Currency.

(*h*) The term 'branch' as used in this section shall be held to include any branch bank, branch office, branch agency, additional office, or any branch place of business located in any State or Territory of the United States or in the District of Columbia at which deposits are received, or checks paid, or money lent.

(*i*) This section shall not be construed to amend or repeal Section 25 of the Federal Reserve Act, as amended, authorizing the establishment by national banking associations of branches in foreign countries, or dependencies, or insular possessions of the United States.

(*j*) The words 'State bank,' 'State banks,' 'bank,' or 'banks' as used in this section shall be held to include trust companies, savings banks, or other such corporations or institutions carrying on the banking business under the authority of State laws."

Sec. 8. That Section 5190 of the Revised Statutes of the United States be amended to read as follows:

"Sec. 5190. The general business of each national banking association shall be transacted in the place specified in its organization certificate and in the branch or branches, if any, established or maintained by

it in accordance with the provisions of Section 5155 of the Revised Statutes, as amended by this Act."

Sec. 9. That the first paragraph of Section 9 of the Federal Reserve Act be amended to read as follows:

"Sec. 9. Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, desiring to become a member of the Federal Reserve System, may make application to the Federal Reserve Board, under such rules and regulations as it may prescribe, for the right to subscribe to the stock of the Federal Reserve bank organized within the district in which the applying bank is located. Such application shall be for the same amount of stock which the applying bank would be required to subscribe to as a national bank. The Federal Reserve Board, subject to the provisions of this Act and to such conditions as it may prescribe pursuant thereto may permit the applying bank to become a stockholder of such Federal Reserve bank."

Any such State bank which, at the date of the approval of this Act, has established and is operating a branch or branches in conformity with the State law, may retain and operate the same while remaining or upon becoming a stockholder of such Federal Reserve bank but no such State bank may retain or acquire stock in a Federal Reserve bank except upon relinquishment of any branch or branches established after the date of the approval of this Act beyond the limits of the city, town, or village in which the parent bank is located. The Federal Reserve Board shall have the discretionary power to define the limits of any such municipal unit in such a way as to include only the territory of a city, town, or village the corporate limits of which at some point coincide with the corporate limits of the city or town in which the parent bank is situated.

The bill in this form came up for discussion in the Senate late in April, 1926.[1] As usual, the discussion was almost entirely taken up with the branch-banking provisions, which, as given above, omitted the so-called "Hull amendments." On May 13, 1926, the Senate passed the bill in its Senate Committee form. The bill then went to a conference committee which, after a two-weeks' deadlock over the Hull amendments and the Federal Reserve banks' charter extension, reached an agreement on everything except the Hull amendments.[2]

[1] *The Commercial and Financial Chronicle,* May 1, 1926, vol. 122, p. 2443.
[2] *Ibid.,* p. 3411.

Compromises of Conference Committee.—The most important compromises of the conference committee were on the subjects of recharter of the Federal Reserve banks and the King resolution.[1] Section 19 of the conference committee bill (formerly Sec. 20 of the Senate bill) granted fifty-year charters to the Federal Reserve banks, and a new Section 20 was added providing for a joint special committee of the House and Senate Banking and Currency Committees, three members from each, "to make an inquiry into the prices of commodities in the United States as affected, since the year 1914, if at all, by the Federal banking laws."[2]

House Rejection.—The committee asked the House to vote on a compromise proposition in place of the Hull amendments. This substitute for the Hull amendments, instead of completely prohibiting national banks from engaging in branch banking in those states which at the time of the passage of the act did not permit state banks to engage in branch banking, would permit such national banks to establish branches, if at any time in the future the state law were altered to permit state banks to establish branches.[3] This privilege, however, was to be closely guarded, since national banks under these circumstances were not to be permitted to establish any branches in cities of less than 100,000 population, only one branch in a city with a population from 100,000 to 250,000; two branches in a city of 250,000 to 500,000; three branches in a city of 500,000 to 750,000; four branches in a city of 750,000 to 1,000,000, and not more than five branches in cities of more than 1,000,000 population.[3] On a test vote on this substitute for the Hull amendment, the House registered its disapproval of the change by a vote of 118 to 197,[4] and the bill was returned to conference with instructions to the House conferees to insist upon the House provisions relating to branch banking.[5] The Senate conferees were also reappointed, and when Congress adjourned in July, 1926, the committee was still deadlocked over the inclusion of the ten words "at the date of

[1] *Ibid.*, June 19, 1926, pp. 3411–3412, *cf.* new Sec. 20.

[2] *Ibid.*, p. 3413.

[3] *Ibid.*, June 19, 1926, vol. 122, pp. 3411–3412.

[4] *Ibid.*, June 26, 1926, vol. 122, pp. 3548–3549.

[5] *Ibid.*, Nov. 13, 1926, vol. 123, p. 2474.

the approval of this Act, and," containing the substance of th Hull amendments.[1]

Public Response to Changes.—In the meantime, the change in the bill had met with varying responses outside the halls o Congress. The Chicago and Cook County Bankers Associatior which sponsored the House form of the bill, denounced th changes made by the Senate Committee, calling special attentioı to the elimination of the Hull amendments and to the sections o the revised bill which would appear to legalize certain nationa bank branches, as in Minnesota, there operating without th consent or approval of the Comptroller of the Currency an located in states whose laws prohibited branch banking. The also objected to the section permitting national banks to opeı additional branches in states whose laws prohibit branch banks.

The "contiguous territory" rule[3] brought opposition fron New York and Ohio, while the proposal to limit national-banl branch banking to cities of 100,000 or more[4] aroused the opposi tion of North Carolina and some other states having no cities o that size.[5]

In an effort to facilitate the passage of the bill, former Comp troller of the Currency Dawes, an active opponent of brancl banking, and Comptroller McIntosh announced that they hac never approved the Hull amendments and that they woulc like to see the bill passed without the amendments.[6] The Federa Reserve Board also requested their elimination.[7]

AMERICAN BANKERS ASSOCIATION REJECTION OF HULL AMENDMENTS

The most important event of the interval between the adjourn ment of Congress in July and its opening of the short session ir

[1] McFadden, in *the Commercial and Financial Chronicle*, July 17, 1926 vol. 123, p. 281.

[2] *Ibid.*, May 1, 1926, vol. 122, pp. 2442–2443. *Cf.* Sec. 7 (*a*) and (*d* quoted above, p. 170.

[3] *Cf.* Sec. 7 (*f*) and Sec. 9, closing sentence, quoted above, pp. 171–172.

[4] *Cf.* above, p. 173.

[5] *The Commercial and Financial Chronicle*, June 26, 1926, vol. 122, p. 3548

[6] *Ibid.*, July 3, 1926, vol. 123, pp. 36–37.

[7] *Ibid.*, p. 37, letter dated June 3, 1926, quoted.

December, 1926, was the rejection of the Hull amendments by the annual convention of the American Bankers Association meeting at Los Angeles in October, 1926. During the summer there had been rumors of a split in the American Bankers Association because of the difference in the interests of the state and national bankers in regard to the Hull amendments and because the more numerous state bankers were in control of the association.[1] It was determined, therefore, to "thresh" the whole question out at the Los Angeles meeting. The State Bank Division insisted on the Hull amendments, and the National Bank Division favored the bill without the Hull amendments.[2]

A night session of the convention was held, and, after a debate lasting nearly all night, on the morning of Oct. 6, 1926, the association rejected the Hull amendments by a vote of 413 to 268 and adopted the following resolution which had been adopted by the National Bank Division of the association the day before:[3]

> That no national bank be permitted in any State to establish a branch beyond the corporate limit of the municipality in which the bank is situated.
>
> Second, that no national bank be permitted to establish a home city branch in any State which does not, at the time of such establishment, permit the State banks to establish branches.
>
> Third, that no State bank be permitted to enter or retain membership in the Federal Reserve System if it has in operation any branch which may have been established after the enactment of H. R. No. 2 beyond the corporate limits of the municipality in which the bank is situated.
>
> Fourth, that no branches which may have been established after the enactment of H. R. 2 beyond the incorporate limits of the municipality in which the parent bank is situated be permitted to be retained when the State bank converts into or consolidates with the national bank, or when two or three national banks consolidate.

These resolutions constituted an endorsement of the Senate form of the McFadden bill, except that they did not provide for the inclusion of contiguous territory in the municipal unit within which branches might be established. The rejection of the Hull

[1] *The New York Sun*, Aug. 19, 1926, p. 12. "McFadden Bill Splits Bankers."

[2] *The Commercial and Financial Chronicle*, Oct. 9, 1926, vol. 123, p. 1832.

[3] *Ibid.*, p. 1833.

amendments by the bankers' association became the more significant in that the House of Representatives appears to have insisted upon the Hull amendments largely because they thought that the bankers had wanted them since the Chicago convention of the American Bankers Association, 1924, had recommended the passage of the bill with these amendments.[1] Congressman McFadden, in an address before a group of business men, on Nov. 10, 1926, said that the conference committee had reached agreement on everything except the "Hull amendment."

> If the Conference Committee can reach an agreement on this disputed point before the second session of the 69th Congress adjourns on March 4, 1927, the bill will become a law. If an agreement cannot be reached the legislation will fail.[2]

Congressman Luce, of the House Committee on Banking and Currency, speaking before the stockholders of the Boston Federal Reserve Bank, stated that he felt reasonably sure that the deadlock would not be broken in the coming short session of Congress.[3]

The Republican party reverses in the November elections had little bearing on the action of the last or short session of the Sixty-ninth Congress, which convened in December, 1926. In view of the general denunciation, during the summer and fall of 1926, of the Hull amendments as unjust, undesirable, and likely to prove ineffective for their avowed purpose,[4] it seemed quite likely that the House would recede from its extreme insistence upon the inclusion of the Hull amendments in the proposed legislation and that the measure would be enacted in conformity with the resolutions adopted by the Los Angeles convention of the American Bankers Association. Although beaten at the Los Angeles meeting, the adherents of the Hull amendments were prepared to carry their fight to Congress. For this purpose, there was formed a Committee of One Hundred, with E. N. Baty as secretary.[5] Mr. Baty had been secretary of various Chicago groups opposing branch banking.

[1] McFadden, in *The New York Sun*, Aug. 19, 1926, p. 12.

[2] *The Commercial and Financial Chronicle*, Nov. 13, 1926, vol. 123, p. 2472.

[3] *Ibid.*, Nov. 6, 1926, vol. 123, p. 2345.

[4] *Cf. ibid.*, Nov. 13, 1926, p. 2474.

[5] *Ibid.*, Oct. 9, 1926, p. 1834.

PASSAGE OF THE McFADDEN BILL, FEB. 25, 1927

Since the House members of the Conference Committee had been instructed to insist on the Hull amendments and the Senate members knew that the Senate would not accept these amendments, the committee was compelled to report a disagreement.[1] The House, however on Jan. 24, 1927, adopted a resolution accepting all of the important amendments to the bill made by the Senate committee and making certain slight further amendments.[1] The changes made by this resolution will be summarized later. The House resolution then came before the Senate. On Feb. 12, 1927, it was made the "unfinished business of the Senate" by a vote of fifty-eight to nine,[2] and on Feb. 15 a closure motion (for the third time in the history of the Senate) restricting debate was adopted by a vote of sixty-five to eighteen.[2] Thus, the attempt of the irreconcilable senators to talk the measure to death was defeated, and on Feb. 16 the resolution was adopted unchanged with a vote of seventy-one to seventeen.[2] The bill had never been looked upon as a party measure, and the votes were as evenly divided as possible between the parties; forty Republican and thirty-one Democratic senators voted for the resolution, and nine Republican, seven Democratic, and one Farmer Labor senators voted against it.[2] Not even minor changes, such as the introduction of commas or other merely verbal improvements, were ventured by the Senate, lest the measure be endangered in these last fiery days of the short session.[3] The resolution was adopted amid bitter charges and recriminations. It was charged that the advocates of the bill had made a deal with the supporters of farm-relief legislation,[4] and the rumors of lobbying activities were so rife that Senator Glass presented a resolution asking for an investigation of the alleged lobbying in connection with the passage of the act.[5] This resolution was adopted by the Senate on Mar. 4. It was one of

[1] *Ibid.*, Jan. 29, 1927, p. 596; Feb. 5, 1927, p. 725.

[2] *Ibid.*, Feb. 19, 1927, p. 994.

[3] *Ibid.*, pp. 994–995.

[4] *Ibid.*, Feb. 12, 1927, "What Price McFadden? The Branch Banking Bill," p. 849.

[5] *Ibid.*, Feb. 19, 1927, pp. 996–997.

the few uncontested measures in the bitter hours of that last day of the session.[1]

On Feb. 25, 1927, President Coolidge had signed the measure making the McFadden Bill a law.[2] The text of this act is given in the appendix. The following paragraphs will deal with the most important features of the act.

THE ACT OF FEB. 25, 1927

City Branches.—The act, as finally passed, bore more resemblance to the Senate committee form of the bill than to the House bill or to the compromise suggested at the close of the first session of the Sixty-ninth Congress. The parts of the bill relating directly to branch banking have been quoted verbatim above. The changes introduced by the resolution of Jan. 24 were, first, the elimination of subsections (*d*) and (*f*) of Section 7 and the closing sentence of Section 9.[3] These eliminated subsections embodied the so-called "contiguous-territory rule" as well as a provision for further branches by national banks where national bank branches already existed, even where the state law prohibited branch banking. The act as passed, therefore, provides that in states where branch banking is now, or in the future may be, permitted by state law, both national banks and state bank members of the Federal Reserve System may establish and maintain branches within city limits in the city where the parent bank is located. The act says nothing as to the number of such branches which a state bank member may establish, but national banks are restricted as follows: No national bank branches are to be established in cities of less than 25,000 population. "No more than one such branch may be thus established where the population . . . of such municipal unit does not exceed 50,000," not more than two for a population up to 100,000, and above that the number rests with the discretion of the Comptroller of the Currency.[4] (Whether the act provides a limit of total branches in the city or of branches per bank is not entirely clear, though it appears to limit the total number.) While the act does not

[1] *Ibid.*, Mar. 5, 1927, p. 1298.
[2] *Ibid.*, Feb. 26, 1927, p. 1161.
[3] *Supra*, pp. 170–172.
[4] Act, Sec. 7, Subsec. (*d*). See appendix.

define the meaning of "city limits," the elimination of the clauses giving administrative authorities power to define that term to include contiguous territory would seem to necessitate the assumption that "city limits" is the same as "incorporate limits of the municipality."[1]

Country Branches.—Not only does the act forbid present national banks and state member banks to establish new branches outside the prescribed limits, but it also prohibits any bank from becoming either a national bank or a state member bank without first relinquishing any such forbidden branches established after the date of the approval of this act.[2] In this connection, the significance of one phrase in the act might easily be overlooked. Subsection (*d*) of Section 7 reads as follows:

> If a State bank is hereafter converted into or consolidated with a national banking association, or if two or more national banking associations are consolidated, such converted or consolidated association may, with respect to any of such banks, retain and operate any of their branches which may have been in lawful operation by any bank at the date of the approval of this Act.

Should it be assumed that "by any bank" is synonymous with "by any *such* bank?" The courts are not likely to take that view, yet the act, as it stands, legalizes a spread of intercommunity branch banking of such scope that the omission of "such" in the above phrase can be deemed only as a most serious oversight on the part of branch-banking opponents. To put the matter more specifically, the law would permit a California state bank or a North Carolina state bank, non-members of the Federal Reserve System, to weld together by consolidation under state laws scattered *existing* country branch-banking systems and to convert into or consolidate with a national banking association or join the Federal Reserve System as a member bank and still continue to operate all of the branches which were previously operated by the small country banks absorbed. It would be necessary, of course, for the new bank to close the former head office of the country bank, for that was not a branch in lawful operation "by any bank" at the date of the approval of the act. That such a development was not intended by the framers of

[1] *Supra*, pp. 174–175, resolutions of the American Bankers Association.

[2] Act, Secs. 7, 9. See appendix.

the act is indicated, in part, at least, by the first section of the act, which permits the consolidation into national associations of only those banks which are "in the same county, city, town, or village."[1]

Interlocking Directorates.—A second change introduced by the House resolution was the elimination of a provision for liberalizing the Clayton Act restrictions on interlocking directorates of national banks.[2] This change has only an indirect bearing on branch banking, though, obviously, a removal of restrictions on interlocking directorates might tend to facilitate chain banking, which is very like branch banking in some ways and is commonly looked upon as a substitute for branch banking.

Other Features.—Certain other features of the act require at least passing comment. Section 2 (*a*) granted indeterminate charters to national banks, thus facilitating the trust company business which they have recently undertaken and which was hampered by terminating charters. Section 2 (*b*) gave the national banks the right to "buy and sell" "investment securities." The term "investment securities" includes notes, bonds, and debentures and is made subject to "further definition" by the Comptroller of the Currency. It has been claimed that this makes the measure a federal "blue sky" act.[3] It would seem, however, that such a minimum regulation of investments is absolutely necessary for banks which are doing a savings-bank business as well as commercial and investment. The act does not separate the savings business of the national banks from their other business, nor does it provide a restricted list of investments for savings deposits.

Real-estate Loans.—The act has extended the power of national banks to lend on real estate, increasing the maturity of such loans to five years and permitting the total of such loans to amount to 25 per cent of the capital and surplus of the bank or one-half of the savings deposits at the election of the association.[4] It, moreover, made direct provision for savings deposits in the following terms:

[1] Act, Sec. 1, an amendment to the Act of Nov. 7, 1918. See appendix.

[2] *The Commercial and Financial Chronicle*, Feb. 19, 1927, p. 994.

[3] *Ibid.*, Feb. 26, 1927, p. 1162.

[4] Act, Sec. 15.

Such banks may continue hereafter as heretofore to receive time and savings deposits and to pay interest on the same, but the rate of interest which such banks may pay upon such time deposits or upon savings shall not exceed the maximum rate authorized by law to be paid upon such deposits by State banks and trust companies organized under the laws of the State wherein such national banking association is located.[1]

As previously noted, these provisions for the conduct of a savings-bank business will tend to aid the national banks in competition with state branch-banking systems, as in Detroit and in California.[2]

Suburban Banks.—To meet the need for banking facilities in outlying sections of large cities, the act provides that in cities with a population of more than 50,000, no national banking association shall be organized with a capital of less than $200,000,

. . . except that in the outlying districts of such a city where the State laws permit the organization of State banks with a capital of $100,000 or less, national banking associations now organized or hereafter organized may, with the approval of the Comptroller of the Currency, have a capital of not less than $100,000.[3]

It is clear that such smaller suburban banks are needed to provide adequate and convenient service in certain large cities where branch banking is not permitted. They are very likely to have close relations with large city banks and, indeed, in many cases, to be merely parts of banking chains.[4]

Section 5200 R. S.—Section 10 of the act rewrites Section 5200 of the Revised Statutes of the United States, which had been called the "heart of the National Banking Act."[5] This is the section which limits a national bank's loans to a single person or firm to 10 per cent of the bank's capital and surplus. The change made by the new section is very detailed, providing certain exceptions to the 10 per cent rule where the loans are made on certain types of specially secured paper.[6]

Overcertification.—The change brought by Section 12 of the Act is a revision of the section of the revised statutes dealing

[1] *Ibid.*

[2] *Supra*, pp. 90–100, 125.

[3] Act, Sec. 4.

[4] Interviews with bankers in Chicago, Detroit, and Philadelphia.

[5] *The Commercial and Financial Chronicle*, Feb. 26, 1927, p. 1162.

[6] For details see appendix, text of Act, Sec. 10.

with overcertification by national banks. The intention appears to be to prevent the evasion of the spirit of the law by so-called "day loans" to stockbrokers. This is hoped to be accomplished by substituting in Section 5208 for the words "or who shall certify a check before the amount thereof shall have been regularly entered to the credit of the drawer upon the books of the bank" the following: "or who shall certify a check before the amount thereof shall have been regularly deposited in the bank by the drawer thereof."[1] Still, it appears that this provision is as ineffectual in preventing "day loans" as the provision which has been replaced, for the proceeds of a day loan may be as easily deposited as those of any other kind of loan.[2]

Indeterminate Charters of Federal Reserve Banks.—Section 18 grants indeterminate charters to the Federal Reserve Banks, and Section 19 permits the Federal Reserve Board to require the discontinuance of any branch of a Federal Reserve Bank.[3] Thus, it should be noted, the compromise measure of fifty-year charters for Federal Reserve Banks and Section 20 calling for an inquiry into prices in the United States "as affected, since the year 1914, if at all, by the Federal banking laws" were eliminated from the final act.[4]

PROBABLE GENERAL EFFECTS OF THE ACT

Movement for State Legislation.—The practical effect of the whole act on the branch-banking situation is likely to be comparatively slight. Perhaps the most important general effect will be to bring about a greater uniformity in the branch-banking laws and practices of the various states. It is to be expected that the state bankers will be irked by the greater restrictions of

[1] Act, Sec. 12. See appendix.

[2] For a different interpretation, see PRESTON, H. H., "The McFadden Banking Act," *American Economic Review*, June, 1927, p. 202; "Formerly the law required that the amount of a check to be certified must be 'regularly entered to the drawer upon the books of the bank'. A deposit of money and simultaneous certification of a check for that amount was therefore illegal since the deposit had not yet been carried to the books of the bank. This was amended to permit certification when the drawer of the check has the amount 'regularly deposited in the bank.' "

[3] Act, Secs. 18, 19.

[4] *Supra*, p. 173.

state law, as in Pennsylvania, Massachusetts, and Michigan, and will endeavor to obtain legislation granting them at least as great powers as those given to national banks by the federal law.

Statutory Rules More Rigid.—The branch-banking features of the act do little more than make statutory previously existing administrative rules. Instead of "additional offices" formerly permitted by the Comptroller of the Currency, "full-power" branches are now definitely permitted by law. The banks are thus freed from the danger of a Supreme Court decision declaring such limited branch banking illegal for national banks, and they are permitted by the law to lend as well as to receive deposits and pay checks at the branches. The testimony, however, of numerous national bankers engaged in operating such "additional offices" indicates that compliance with the prohibition of lending at these offices was purely nominal.[1]

The other administrative rule which is made statutory by the act is the former Federal Reserve Board prohibition of new out-of-the-city branches for state bank members of the Federal Reserve System.[2] In this case, the import of the former rule has been more materially changed, since not only is the reserved right of the Federal Reserve Board to make exceptions to the rule abolished but also the establishment of branches in contiguous territory is forbidden.

Pressure on Federal Reserve Members.—The recent expansion of the Bank of Italy and its ultimate nationalization with 276 branches show to what extent the permissive or exceptional features of the administrative rules could be made use of in an emergency.[3] Moreover, as shown above, *existing* branches may be used even under the law to build up systems of intercommunity branch banking.[4] Nevertheless, the almost inevitable result of this prohibition of out-of-the-city branches will be that the great branch-bank members (as well as those not engaged in branch banking) of the Federal Reserve System will be faced with strong branch-bank competition from non-member banks.

[1] Personal interviews with bankers in San Francisco, Detroit, Boston, and New York.

[2] *Cf. supra*, pp. 159–160.

[3] *Supra*, pp. 161–162.

[4] *Supra*, pp. 179–180.

As this competition increases in strength, the members will be compelled to weigh carefully the benefits of Federal Reserve membership as compared with the advantages of establishing new out-of-the-city branches. At the best, the prohibition imposed on member banks only weakens the Federal Reserve System by permitting non-member banks to expand at the expense of member banks and at the worst it may lead to wholesale defections from the system as the members find the rule too burdensome.[1]

Prevent Federal Reserve Growth in South.—In the Southern states, where state-wide branch banking is permitted, very few of the banks are members of the Federal Reserve System. Therefore, the legislative restriction of branch-banking activities of Federal Reserve members will have a negligible effect in preventing the growth of branch banking in those states. Without this restriction, the gradual spread of branch banking and the consequent increase in the size of the banks might have caused many banks to avail themselves of the privileges of Federal Reserve membership, since it is the large banks which have most to gain from such membership. As it stands now, the law will have merely the undesirable effect of lessening the chances of Federal Reserve growth in the South and of increasing the strength of Southern opposition already sufficiently aroused by the par-clearance controversy.[2]

[1] It should be said to the credit of the California branch bankers that they refused to threaten a withdrawal from the system on account of threatened discriminatory legislation.

[2] *Supra*, p. 147.

CHAPTER XVII

BRANCH BANKING IN SCOTLAND, ENGLAND, FRANCE, AND CANADA

In considering the desirability of branch banking for the United States, some reference to foreign experiences with branch banking is unavoidable. All of the important commercial countries of Europe have developed systems of branch banks. In fact, it is hard, indeed, to find an important country in the whole world which does not have branch banking. Those countries which have been selected for discussion in this chapter are the countries whose experiences appear most valuable for comparative purposes.

Scotland may be looked upon as the birthplace of branch banking, and in that country branch banking has reached its fullest development. England, with its legal restrictions on note issue, more nearly resembles the United States than does any other foreign country. Moreover, the methods of business and much of the commercial law are similar in the two countries. The experience in France might be passed over without discussion, if it were not for the fact that it is common knowledge of the American student that branch banking is characteristic of the French system and the further fact that critics of branch banking have pointed to recent French experiences to try to prove that branch banking would be undesirable for the United States. Canadian institutions interest Americans not only because they are so near at hand but also because they are dealing with conditions essentially American in character and particularly because they show what might have been the development of banking institutions in the United States if it had not been for the Civil War and the National Bank Act.

SCOTLAND

Earliest Branches.—The Scotch experience with branch banking is both the earliest and, in many respects, the most interesting. The Bank of Scotland, which received a royal

charter in 1695, attempted to establish several branches in the following year. The branches proved unprofitable and were quickly abandoned.[1] In 1731, a second attempt to establish branches was made, and again the branches proved unprofitable and were quickly closed.[1] Coincident with the doubling of the bank's capital, in 1774, however, a successful policy of establishing branches was instituted.[2] Even as late as this date there were few private and joint-stock banks in Scotland.

After 1774.—In the following fifty years, a number of joint-stock banks were formed, and as they grew in size they followed the policy of establishing branches, so that by the year 1826 there were 123 branches in Scotland operated by 21 parent banks.[3] At this time there were also 10 banks which had the note-issue privilege but which did not have branches as well as 4 private banks which neither issued notes nor had branches.

A growing concentration of banking control was already apparent. There were 8 banks in Edinburgh, 4 of which had 82 branches, 1 had only 1 branch, and the remaining 3 had no branches. There were 3 banks in Aberdeen, 1 with 6 branches and 1 with 4.[3] This meant that all but 30 of the 123 branches in Scotland were controlled by head offices in Edinburgh or Aberdeen.

1826–1848.—In the following twenty-two years, the growth of branch banking was rapid, and by the year 1848, there were 382 branches in Scotland and only 18 joint-stock banks and chartered banks, all engaged in branch banking, and 1 private bank without branches.[4] The head offices of the 18 parent banks were located in six cities in Scotland, and all of the other cities and towns were dependent for banking service upon branches of these banks.[5] Parent banks located in Edinburgh,

[1] Conant, Charles A., "A History of Modern Banks of Issue," 5th ed., p. 148.

[2] *Ibid.* A slight development of branch banking had preceded this, for it appears that the crisis of 1772 had caused a run upon the Edinburgh branch of the Ayr Bank. *Cf.* Conant, *op. cit.*, p. 147.

[3] Gilbart, James William, "A Practical Treatise on Banking." 3rd American ed., 1855, pp. 314–315.

[4] *Ibid.*, pp. 315–316.

[5] *Ibid.*, p. 319.

Glasgow, and Aberdeen controlled all but 20 of the 382 branches. The decline in number of banks from 35, in 1826, to 18, in 1848, had taken place in spite of the establishment of 14 new banks in the intervening years. Some of the banks existing in 1848 were the results of consolidations of preexisting institutions. Some of the old banks had failed, and some had simply decided to withdraw from the field.[1] Only 9 of the 31 issuing banks of 1826 remained in 1848.[2]

Limited Liability.—The stockholders of these early joint-stock banks were denied the right to limit their liability for the debts of the banks. Parliament passed an act in 1858 permitting the formation of limited companies for carrying on the banking business. This action resulted from the disastrous failure in the previous year of the Western Bank of Scotland and the Borough Bank of Liverpool.[3] Moreover, the failure of the City of Glasgow Bank in 1878 led to the passage of an act enabling unlimited banks to register as "limited" subject to certain conditions.[4]

Movement Unchecked by Failures.—The branch-banking movement proceeded unchecked despite the great losses to stockholders of the two failed Scotch banks. The creditors of the banks were paid in full.[5] As a result of this record of few failures and those without loss to the noteholders and depositors, the Scotch banks enjoy an almost unparalleled credit with the public.[6] Through a process of gradual expansion, the number of branches in Scotland had increased to 1,245 by the year 1915. while the number of banks had declined to 8.[7] All of these banks enjoyed the note-issue privilege at that date and had been in business for more than three-quarters of a century; one, indeed,

[1] *Ibid.*, p. 317.

[2] *Ibid.*, p. 318: "Most of the banks that have ceased to exist were banks having only a few partners, and their capital unknown. The banks that have since been formed have many partners, and generally a large amount of capital. It was probably in consequence of the greater strength of the new banks that the old ones found it expedient to discontinue business."

[3] Marshall, Alfred, "Money Credit and Commerce," p. 88.

[4] *Ibid. Cf.*, also, Blyth, Robert, in Phillips, C. A., "Readings in Money and Banking," p. 487.

[5] Phillips, *op. cit.*, p. 484, quoting Tait, Adam.

[6] Phillips, *op. cit.*, p. 478, quoting Withers, Hartley.

[7] *Ibid.*, p. 474.

was more than two centuries old, and another was almost as old.

The following list shows the age as well as the names and locations of the Scotch banks:[1]

	Head office	Established
Bank of Scotland	Edinburgh	1695
Royal Bank of Scotland	Edinburgh	1727
British Linen Company	Edinburgh	1746
Commercial Bank of Scotland, Limited	Edinburgh	1810
National Bank of Scotland, Limited	Edinburgh	1825
North of Scotland and Town and County Bank, Limited	Aberdeen	1825[1]
Union Bank of Scotland, Limited	Glasgow	1829
Clydesdale Bank, Limited	Glasgow	1838

[1] GILBART, *op. cit.*, pp. 314–315, The North of Scotland Bank (Aberdeen) was established October, 1836, and the Aberdeen Town and County Bank was established in 1825.

LESSONS FROM THE SCOTCH EXPERIENCE

The American opponents of branch banking have made numerous charges as to the evils of branch banking. The most serious of these charges may be summarized in the form of four interrelated propositions: (1) Branch banking drives the unit banks out of business; (2) branch banking, thus reducing the number of banks, ultimately leads to monopoly in banking; (3) this monopolistic control of banking is exercised by a group of bankers in a central city of the country, with the result that loans elsewhere must be made on collateral security rather than on the character and worth of the man applying for a loan at a branch; and (4) branch banking in the United States would destroy the Federal Reserve System, thus substituting a private reserve system for the public system now in use.[2]

[1] PHILLIPS, *op. cit.*, p. 482; GILBART, *op. cit.*, pp. 314–316.

[2] *Comptroller Dawes on Branch Banking*, a pamphlet distributed by the California League of Independent Bankers; *cf.*, also, *Report* of the Comptroller of the Currency, 1923, pp. 3–17.; 1924, pp. 3–4: "Under such conditions a bank would eventually degenerate into a glorified pawnshop, from which collateral had excluded character as an element in credit." *Cf.*, also, MACDONNELL, "The Community Bank *vs.* the Branch Bank: An Address," Jan. 27, 1923.

Elimination of Unit Banks.—The experience in Scotland throws light on each of these objections to branch banking. As regards the first objection, it is true that unit banks, meaning local banks not engaged in branch banking, no longer exist in Scotland, but there never were many unit banks there. Nearly all of the branches of banks in Scotland were established as branches, and very few resulted from the taking over of independent institutions.[1] While it cannot be maintained that branch banking in Scotland drove out any strong unit banks such as we have in the United States, still, it must be admitted that such unit banks have not been demonstrably able to withstand branch-bank competition. The elimination, however, of the unit banks in and of itself is not an evil, except, perhaps, to the unit banker.[2]

Monopoly.—Scotch experience gives an undoubted air of validity to the monopoly charge. The parent banks have been reduced to eight, and these eight act in close cooperation.

> They agree absolutely and arbitrarily among themselves as to the rates they will allow to depositors, the rates at which they will advance or discount, and the terms and commissions for which they will do business for customers.[3]

In spite of the appearance of things, competition is still an active force, since the individual banks depend upon their own business for their profits and must offer more efficient service, rather than lower charges, as the inducement for customers' trade. Moreover, the larger borrowers, especially, find it easy to resort to the nearby English banks if they feel that they can obtain better terms "south of the Tweed."[3] Clearing houses in the United States have adopted rules for the curbing of "cut-throat competition." They fix uniform rates of interest on deposits and uniform exchange and collection charges.[4] Such semimonopolistic devices are thus not confined to countries having branch banking as the predominant system.

[1] Phillips, *op. cit.*, pp. 484, 486.

[2] *The Commercial and Financial Chronicle*, American Bankers Convention Section, Oct. 16, 1926. A small-town banker says: "I am against branch banking because I am afraid it will absorb me, put me out of business, and I don't just like that. I am kind of human."

[3] Phillips, *op. cit.*, p. 479, quoting Withers.

[4] Westerfield, "Banking Principles and Practice," p. 464.

Regulation Possible.—Even if it were admitted, however, that branch banking inevitably led to monopoly, that would not settle the question, for it is necessary to consider whether such a monopoly is undesirable. The public has ceased to reverence competition after the fashion of a century ago. In many fields, monopoly is now the accepted rule. This is especially true in regard to such public utilities as the telephone, waterworks, gas plants, and electric-light plants. Where competition leads to useless duplication and, in general, economic waste, properly regulated monopoly is certainly preferable, if not inevitable. In an elemental way, this proposition is already applied to banking in the United States by both state and national laws, since the administrative authorities are instructed not to permit the establishment of new banks, except where there is a need for additional banking facilities.[1] The effect of such a rule is to create thousands of limited local banking monopolies in the United States, since many towns are too small to support more than one independent bank. In California alone, in the year 1924, there were 251 towns having banking institutions with such local monopolies of the banking business.[2]

Finally, even if it be admitted that monopoly is likely to produce undesirable results, the remedy need not be enforced competition but may take the form of public regulation of some sort. In any case, it must be said that the Scotch experience does not warrant the conclusion that monopoly is the inevitable end of a branch-banking policy.

Centralization.—The third objection, which has to do with centralization of credit control, is like the others, substantiated in part and in part contradicted by the Scotch experience. The fact that only three cities in Scotland have head offices of banks indicates the tendency toward centralization, but the very existence of Scotch banks shows the vitality of regional banks. The Scotch banks have been able to survive independently of the great English banks, though not without affiliations, to be sure, in all cases.[3]

[1] Westerfield, "Banking Principles and Practice," p. 387.

[2] *Annual Report* of the Superintendent of Banks of California, 1924, computation by the writer.

[3] The British Linen Bank (Edinburgh), for example, is affiliated with Barclays Bank (London).

Such a concentration of control of lending has its good as well as its bad aspects. The need for funds in any place is indicated by the willingness and ability of borrowers to pay interest on loans. The branch banker following the law of self-interest will serve the community, as a whole, by transferring funds from those places where the demand for loans is slight to those places where the demand is great. In Scotland, the banks maintain uniform rates throughout the country, both for deposits and loans.[1] This gives both lenders and borrowers the benefit of a national market for their operations. So far as unit banking prevents a ready flow of funds *out of* one community (this is deemed a merit by the advocates of that system),[2] it obviously and to the same extent prevents a flow of funds *into* some other community. While this localization of banking funds is intended to operate for the borrower's advantage and without regard to any loss to the depositor, either through bad loans or low interest, it also injures the borrowers as a class, since they lose the advantage of the free inward flow of funds.[3]

Cash Credits.—One feature of the Scotch system is especially significant in view of the charge that branch banking inevitably leads to an overemphasis of collateral security as a basis of loans. Although the Scotch banks properly regard collateral security as very desirable, they have developed a famous system of lending on the basis of character, the "cash-credit system,"[4] as it is called. No collateral is required for a cash credit. The cash credit corresponds closely with what is known in this country as a "line of credit," except that the cash credit is established when the person who is borrowing obtains two persons who will guarantee payment of his loans to the bank.[5] The system rests

[1] PHILLIPS, *op. cit.*, pp. 479, 484. [2] BATY, E. N., interview, 1926.

[3] *Cf.* MACLEOD, HENRY DUNNING, "A History of Banking in Great Britain, vol. II, p. 175. Shows advantages of Scotch system.

[4] PHILLIPS, *op. cit.*, pp. 481, 486.

[5] GILBART, *op. cit.*, p. 332: "A cash credit is an undertaking on the part of the bank to advance to an individual such sums of money as he may from time to time require, not exceeding in the whole a certain definite amount, the individual to whom the credit is given entering into a bond with securities, generally two in number, for the repayment on demand of the sums actually advanced, with interest upon each issue from the day upon which it is made."

upon character and business ability as attested to by the faith of the borrower's neighbors. The ordinary commercial banks do not make a practice of extending credit on this basis in the United States, but the Morris plan banks have been very successful in applying a similar principle, lending entirely on notes signed by the borrower and two comakers. The Scotch plan is more comprehensive, including loans to rich and poor, though in earlier times the loans were rarely below £100, generally 200 to £500, and sometimes as much as £1,000.[1]

The Scotch cash credits have been greatly admired. The system has many merits:[2] It enables young men of good character to acquire wealth and respectability; it tends to prevent manufacturers' setting up as bankers, since they can obtain adequate and cheap credit from the banks;[3] it exerts a considerable moral influence, since the "securities" watch the borrower and may withdraw their support if he does not conduct himself well.[4] This system, based upon character, and not collateral, has worked very well under a system of branch banking, and the progress of the Morris plan banks indicates that a similar device might be used by American banks, if branch banking became the order of the day and if branch managers were compelled to operate under rigid rules from the head office.

Destruction of Public Reserve System.—The fourth objection to branch banking in the United States, namely, that branch banking would destroy the Federal Reserve System, is not supported by Scotch experience. Despite the completeness with which the branch banks occupy the field of banking in Scotland, the Bank of England is still the center of the British banking system, Scotch as well as English.[5] As long as branch-banking systems in the United States continue along their present lines of development, that is, confined to state limits,

[1] *Ibid.*

[2] *Ibid.*, pp. 333–334.

[3] *Ibid.*, p. 334: ". . . the temptation is removed from the manufacturer, of attempting to issue notes, and becoming himself a banker, an error or temptation which, if what is said is true, has been the main cause of the institution of many insufficient English bankers" who have brought bad banking and its evils.

[4] *Ibid.*, p. 335.

[5] Phillips, *op. cit.*, p. 480, quoting Withers.

the systems will find the Federal Reserve banks highly useful agencies, and even if the future should bring an interstate development of branch-banking systems, a central reserve institution would be needed and the banks would recognize the need. Certain of the functions of the Federal Reserve System, such as the transfer of funds and clearing and collection, might be taken over by the branch banks. This would merely change the system without destroying it. Present branch-banking practices have strengthened the system, rather than weakened it, for the important branch banks are members of the system, and the national banks which have disappeared into branches, as well as non-member state banks converted into branches of member banks, have maintained and increased Federal Reserve Bank resources.[1] The argument that branch banking will destroy the system through destroying the national banks which are "compulsory" members of the system[2] is so weak as to be almost puerile. National banks are not compulsory members of the Federal Reserve System, for they are not compelled to remain national banks. The present national banks are primarily commercial banks, and for them there is a great advantage in membership in the Federal Reserve System. The success of the Federal Reserve System must rest, in the long run, upon a mutuality of advantage between it and the members, rather than upon compulsion. An apparent compulsion may have helped to start the system, but the continuance of the system must be based on an appreciation of its advantages.

ENGLAND

Early Legal Obstacles.—Branch banking began much later in England than in Scotland. The lateness of its appearance was the result of legal obstacles to the formation of banking companies having sufficient capital to carry on the branch-banking business. The Bank of England, given a monopoly of banking in England in 1697, refused to establish branches for many years.[3] The charter of 1709 made the banking monopoly provision more explicit.[4] Not only were banking companies not

[1] *Cf. supra*, pp. 96–97, 128–129, 133, 142, 146.

[2] *Report* of the Comptroller of the Currency, 1923, pp. 6–7.

[3] Andreades, A., "History of the Bank of England," p. 113.

[4] *Ibid.*, p. 123.

to be chartered by Parliament, but also all partnerships or companies of more than six partners were prohibited from issuing notes payable on demand, that is, from doing a banking business as it was then understood.[1] This monopoly of note issue was continued by various acts and charters and effectually prevented the formation of "joint-stock" companies for the purpose of carrying on the banking business, until an act was passed, in 1826, permitting the formation of joint-stock banks, that is, copartnerships of more than six in number,

> . . . to carry on business as bankers in England, sixty-five miles from London, provided they have no house of business or establishment as bankers in London, and that every member of such copartnership shall be responsible for all of the debts of the company.[2]

The act also authorized the Bank of England to establish branches in the provincial towns.[3] This act was the direct result of the "dog in the manger" policy of the Bank of England, which had led to very bad country banking conditions. The bank had insisted on preventing the formation of banks of more than six partners and yet refused to establish branches in the country to provide a satisfactory currency.[4] It was to remedy this condition where the small business men were sole issuers of bank notes in the provinces that the Act of 1826 was passed.[5] Stirred out of its inaction by the "authorization" to establish branches and by the prospective competition of country joint-stock banks, the Bank of England immediately began to establish branches. By 1832, it had eleven such branches in operation; one other branch was added in 1834, and still another in 1844;[6] however, the number has since declined to eleven, two of which are in London.[7]

Joint-stock Banks.—While the Bank of England thus reluctantly and slowly engaged in branch banking, the newly author-

[1] *Ibid.*

[2] Gilbart, *op. cit.*, p. 300.

[3] *Ibid.*, p. 238.

[4] Andreades, *op. cit.*, pp. 254–255.

[5] *Ibid.*, p. 255, the previous system "allowed every small grocer to set up a bank and to issue notes which he was unable to honor."

[6] Gilbart: *op. cit.*, pp. 238–239.

[7] Phillips, *op. cit.*, p. 465.

ized provincial joint-stock banks from the first followed a policy of establishing branches, and by 1836, a committee of the House of Commons reported that

> . . . new companies are daily forming, and that an increased number of branches and agencies are spreading throughout England, even in small towns and villages; that a principle of competition exists, which leads to the extinction of all private banks, and to their conversion into banking companies.[1]

In the meantime, the monopoly of the Bank of England had been further limited by a change in the law, in 1833, which permitted joint-stock companies, even in London, to carry on the business of banking but without the privilege of note issue.[2] The London and Westminster Bank was formed at once and opened the head office and a branch on the same day, Mar. 10, 1834.[3] Within a few years, 4 other London joint-stock banks were formed, and all engaged in branch banking. During the ten years, most of the London banks confined their branches to the city, but the London and County Joint Stock Bank had 45 branches in the country by 1849.[4] The other banks in London had very few branches; the London and Westminster, which had the most, had only 5 in 1841.[5] By 1849, there were as many as 90 country joint-stock banks, of which 33 had no branches and the remaining 57 had a total of 341 branches. One Bristol bank had 24 branches, as did also a Liverpool bank. The National Provincial Bank with head office in London, had the largest system, 60 branches all in the provinces.[6]

Peel Act of 1844.—The famous Peel Act of 1844 contained several provisions which affected the branch-banking development in England:[7] New banks of issue were not to be established in England. If any bank having not more than six partners should exceed that number, it would lose its right to issue. This tended to prevent private banks' merging with joint-stock banks.

[1] GILBART, *op. cit.*, p. 301.
[2] *Ibid.*, p. 233.
[3] *Ibid.*, pp. 259, 267.
[4] *Ibid.*, p. 278.
[5] *Ibid.*, p. 267.
[6] *Ibid.*, pp. 303–305.
[7] Act. 7 and 8 Vict. c. 32; *cf.* GILBART, *op. cit.*, p. 287.

If a union took place between a joint-stock bank and a private bank, or between two joint-stock banks of issue, one of them would lose its right of issue. Every new branch at which notes were issued had to take out a separate license. Before 1844, no bank had been obliged to take out more than four licenses, however numerous its branches. This tended to check the opening of new branches of issue. While these provisions were all adverse to rapid branch-banking development, a further provision that the subscribed capital of new companies must be at least £100,000 and that at least half of this must be paid up before commencing business[1] prevented the formation of small banks and, to that extent, favored branch banking. The act also required that letters patent must be obtained by all joint-stock banks. Previously, they had done business under deeds of settlement over which there was no official supervision. These measures strengthened the position of joint-stock banking.

The "Big Five."—The Peel Act restriction of country bank note issues to the average circulation of the twelve weeks preceding Apr. 27, 1844,[2] had the result of lessening the relative importance of note issue, since the banks turned their attention to the deposit-and-check type of business to an increasing extent. Thus, ultimately, the loss of the note-issue privilege as a result of consolidation became less and less serious, and, as a consequence, the branch-banking movement, based, as it was, on consolidations, proceeded at an accelerating pace. By 1909, 1 bank had over 600 branches; another, over 550; 2 others, more than 400; 3 others had more than 200; and 12 others, more than 100.[3] After the World War, the pace became even more rapid, partly, at least, as a result of the growth of larger business units in other lines.[4] By the year 1926, 5 big joint-stock banks had come to dominate the English banking situation, with their 9,000 branches, largely in England but extending to all parts of Great Britain.[5] These banks, commonly referred to as the "Big Five,"

[1] Act. 7 and 8 Vict. c. 113; *cf.* GILBART, *op. cit.*, p. 308.

[2] GILBART, *op. cit.*, p. 285; Act 7 and 8, Vict., c. 32, Sec. XIII.

[3] PHILLIPS, *op. cit.*, p. 457, quoting WITHERS.

[4] *The Manchester Guardian*, Oct. 2, 1926, p. 52.

[5] CASSON, HERBERT R., in *The Commercial and Financial Chronicle*, Oct. 2, 1926, vol. 123, p. 1703.

are Barclays Bank, London Joint City and Midland, Lloyds Bank, National Provincial and Union Bank, and Westminster Bank.[1] The smallest had deposits amounting to more than $1,000,000,000 and the largest more than $1,500,000,000.[2]

Local Systems.—Nevertheless, strong local systems remained. There were 5 Manchester banks with a total of 1,016 branches, largely confined to the Manchester district.[3] The intimate relation between these banks and the cotton trade appears to have made the owners unwilling to permit their absorption by the London banks.[4] Moreover, the opposition of business men to such an absorption appears to have had some effect in preventing it.[4] There was also a bank in Liverpool with 380 branches.[5]

Competition.—Unlike the Scotch development, the English branch banks have been continually highly competitive.[6] The only appearance of a tendency toward monopoly lies in the continued reduction in the numbers of independent banks. At present, it is claimed that these banks afford the people a "remarkably efficient banking service."[7]

Deposit Banking.—American branch-banking development seems likely to follow along the English lines rather than the Scotch, since the American laws have compelled the banks to turn from note issue to deposit banking, and, partly as a result of this, banking customs in the United States and England bear marked resemblances. Moreover, the California development of branch banking has already manifested much of this intense competition.[8]

[1] Supplement to *Commerce Reports*, July 2, 1923, "British Banking Foreign Policies of the 'Big Five' Banks," by ROBINSON, LELAND REX, pp. 5–7.

[2] *The Commercial and Financial Chronicle*, vol. 123, p. 1703.

[3] *The Manchester Guardian*, Oct. 2, 1926, pp. 52, 53.

[4] *Ibid.*: "These banks have always regarded themselves as being principally bankers to the cotton trade."

[5] *The Commercial and Financial Chronicle*, Nov. 27, 1926, vol. 123, p. vi.

[6] *The Manchester Guardian*, Oct. 2, 1926, p. 53; also PHILLIPS, *op. cit.*, pp. 479–480.

[7] *The Commercial and Financial Chronicle*, Oct. 2, 1926, vol. 123, p. 1703.

[8] *Supra*, pp. 31, 59, 66.

Disappearance of Private Banks.—In England, as in Scotland, the disappearance of private banks furnishes no very convincing evidence that unit banks cannot survive branch-bank competition. The joint-stock banks in England engaged in branch banking from the first. The private banks were too small to do so. Branch banking may have been a factor in the elimination of the private banks, but as long ago as 1870, Walter Bagehot, an acute observer of English banking developments, predicted that the private banks would be driven out or displaced by the joint-stock banks, not as a result of branch banking, but because of certain defects in private banking; the private bankers kept the public in ignorance as to their affairs, publishing no balance sheets; the private banks, as family businesses, ran the risk of falling into the hands of incompetent heirs; finally, even in the hands of competent partners, the private banks were not as well managed as the joint-stock banks, since the partners were busy men of affairs and unwilling to give attention to the details of the banking business which were increasing daily. The joint-stock banks, on the other hand, were organized to give attention to these details, having paid managers giving their full time to the business of the bank.[1]

CANADA

Scotch Influence.—Banking in Canada was greatly influenced by the Scotch immigrants into that country. The first bank of discount, deposit, and issue was the Bank of Montreal, established in 1817 and chartered in 1822.[2] Two-thirds of the charter members of this bank were Scotch.[3] The Scotch influence manifested itself promptly in the manner of conducting the business, particularly in the establishment of branches.[4]

Chartered Banks.—Other chartered banks were formed in the following years and followed the same practice of establishing branches. In Canada, as in the United States in the first half of the nineteenth century, there were attempts to introduce

[1] Bagehot, Walter, "Lombard Street," pp. 271, 273, 276. Written 1870–1873.

[2] Breckinridge, "The Canadian Banking System, 1817–1890," pp. 25, 27.

[3] *Ibid.*, p. 34.

[4] Conant, "A History of Modern Banks of Issue," p. 450.

measures which would lead to a freer extension of credit.[1] The Province of Canada passed a Free Banking Act in 1850 in imitation of the New York system which had been in operation for some years.[2] However, only six banks were ever formed to take advantage of the act, and none of them continued as "free banks" more than a few years.[3] The law was finally repealed in 1866.[3]

General Banking Laws.—The early banking in Canada was conducted by banks operating under provincial and royal charters, but the British North America Act of 1867 gave to the Parliament of Canada exclusive legislative authority over all matters concerning coinage and banking.[4] This came at a time when the national banking system in the United States had effected a great reform in the conditions of note issue in the United States. Although there were serious proposals to adopt a similar system in Canada in order to bring uniformity and safety to the Canadian bank note issues,[5] the bank acts of 1870 and 1871 made no provision for such a bond-secured currency.[6] The Bank Act of 1871, which was the first effective general banking measure in Canada, allowed the Canadian banking system to keep to the natural lines of its growth.[7] By way of concession to the Maritime Provinces, where local banking was more in favor than in other parts of the Dominion, the minimum required capitalization for a bank had been fixed at $500,000 (of which $200,000 had to be paid in before starting business) instead of $1,000,000, as at first proposed by the Minister of Finance.[8] It was strongly contended that only a small capital should be required in order that local rural banks might be established in place of branch banks which would be necessitated by a high requirement.[9] The Act of 1871 yielded slightly to this demand

[1] Breckinridge, "The Canadian Banking System, 1817–1890," pp. 73–79.

[2] *Ibid.*, p. 137.

[3] *Ibid.*, p. 151.

[4] *Ibid.*, p. 219.

[5] *Ibid.*, pp. 219–245.

[6] *Ibid.*, pp. 254, 258.

[7] *Ibid.*, p. 263.

[8] *Ibid.*, p. 249.

[9] *Ibid.*, p. 248.

by reducing the initial paid-up capital to $100,000 with a provision that another $100,000 must be paid within two years.[1]

Reform Measures.—In the following twenty years, bank failures were disturbingly numerous. The low requirement of $100,000 of paid-up capital proved insufficient to prevent the entrance of speculators into the field of banking.[2] To bring greater security to the bank-note circulation, the attempt to introduce the bond-secured type of currency was again made, but Parliament did not seriously consider its adoption.[3] The reform measure actually adopted was very different and provided the fundamental legal basis of the Canadian system as it exists today. The three most important changes made by the Act of 1890 were:[4] first, the provision for a Bank Circulation Redemption Fund, similar to the New York Safety Fund, which gave safety to the bank-note circulation; second, the requirement that the banks establish redemption agencies in certain large cities throughout the Dominion. This insured the circulation of the bank notes at par in all parts of Canada. Third, small speculative banking ventures were discouraged by the provision that the minimum paid-up capital should be $250,000.

Number of Banks.—Although the Bank of Montreal was established as early as 1817 and other banks were chartered in the following years, there were only nine banks in Canada in 1841.[5] The Bank of Montreal was by far the largest of these, having assets of more than £1,000,000, while the next in point of size, the Bank of British North America, had a little more than £500,000 resources. Seven of the banks were chartered, and two were private. By 1867, the number of chartered banks had increased to twenty-eight.[6] The period 1868—1873 was one of great expansion and prosperity in Canada,[7] and the banks shared in this expansion. In these five years, the Dominion Parliament granted twenty-six new banking charters. Eight of these charters were forfeited for "non-user," and only nine of the

[1] *Ibid.*, p. 260.
[2] *Ibid.*, p. 318.
[3] *Ibid.*, pp. 319–321, 331, 332.
[4] *Ibid.*, pp. 332–334, 338–341.
[5] *Ibid.*, p. 121.
[6] *Ibid.*, p. 268.
[7] *Ibid.*, p. 264.

banks were actively engaged in business by June, 1873, at which time the total number of banks, new and old, was only thirty-three.[1] Ten more were in active competition by the end of 1874.[2]

Three banks failed during the period of business depression, 1874–1879, and five in the later period of depression, 1883–1889, and while some sixteen new charters were granted from 1875 to 1886, only four new banks succeeded in getting sufficient capital to start business.[3] By 1894, out of the fifty-six chartered banks at some time in operation in Canada since 1867, only thirty-eight remained.[4] Ten had failed but with a total loss to the public exclusive of stockholders of not more than $2,000,000, which amounted to less than 1 per cent of the total liabilities of Canadian banks at the later date.[4]

Since 1894, there has been a gradual decline in the number of banks and an increase in the number of branches. In October, 1908, there were 30 banks and 1,901 branches.[5] There had been 36 banks with 700 branches in 1900. By 1912, there were only 26 banks, and the number of branches had increased to 2,790. By 1922, the number of banks had declined to 17, while the branches had increased to 4,300.[6] By the end of 1925, 3 banks had been merged with or absorbed by other banks, and the Home Bank had failed with heavy losses to stockholders and depositors. The Home Bank had never been recognized by the other bankers as a sound banking institution, and its failure does not have the same significance that the failure of one of the regular members of the banking fraternity would have.[7]

In 1926, the three largest Canadian banks were the Bank of Montreal, the Royal Bank, and the Canadian Bank of Commerce, having a total of more than $2,000,000,000 of resources and more than 2,000 branches. The Royal Bank had the greatest number

[1] *Ibid.*, pp. 266–268.

[2] *Ibid.*, p. 266.

[3] *Ibid.*, pp. 283–285, 297–298, 306–311.

[4] *Ibid.*, p. 314.

[5] Conant, "A History of Modern Banks of Issue," p. 472.

[6] Ward, John W., "The Canadian Banking System," *Canadian Council of Agriculture Banking Memorandum*, No. 2, p. 4.

[7] Personal interviews with leading Canadian bankers, August, 1926

of branches, namely 884, while the Bank of Montreal surpassed the others in the amount of its assets, $749,000,000.[1] Many branches were closed in 1924 and 1925. There were several reasons for this action. During the period of inflation which was experienced in Canada as a result of the World War, branches were too freely established, and the deflation brought losses to the banks, emphasizing the need for closing redundant branches. Cooperation among the leading bankers has made it possible to effect "trades" in the matter of closing such competitive branches.[2] A second cause of the decline has been the absorption of branch-banking systems into existing systems. In many cases, this resulted in unnecessary duplication of banking service, and the duplication within the system was ended by closing the undesired branches.[3]

Bank Act Amended in 1924.—Before Oct. 1, 1924, there was no government inspection or audit of the banks in Canada, but the failure of the Home Bank and the admitted losses of other banks created a public demand for government supervision. In the 1924 session of Parliament, the Bank Act was amended to provide for the appointment of an Inspector General of Banks who is given full power to inquire into and examine the affairs and business of all chartered banks and is required to make an inspection of each bank at least once in every calendar year.[4] Further, two auditors must be appointed by the shareholders at the annual meeting of the bank to examine into the condition of the bank and report to the shareholders at the next annual meeting.[4] The Canadian bankers express doubts as to the efficacy or value of the new system of government inspection. They anticipate a more or less perfunctory examination of the head office rather than the thoroughgoing type of examination to which the American banks are subjected under state and national laws.[5]

Commercial Character of Business.—The chartered banks of Canada are commercial banks rather than savings banks in their

[1] Compiled from statements of the banks, 1925–1926.

[2] Personal interviews.

[3] The Royal Bank of Canada, *Annual Report*, 1925, p. 15; The Canadian Bank of Commerce, *Annual Report*, 1925, p. 30.

[4] Ward, "The Canadian Banking System," p. 4.

[5] Personal interviews, August, 1926.

general type of business. The great banks of Canada are not permitted to lend on real-estate mortgages.[1] They purchase securities only to a very limited extent, and the great bulk of their resources consists of short-time or commercial paper. While the banks report "savings deposits," so-called, of more than twice the amount of their demand deposits, this does not have the same significance that it would have in the United States, for the banks commonly permit savings depositors to draw checks on their accounts, and the funds derived from savings accounts are invested in short-time loans rather than mortgages or securities. Current account funds are kept in a still more liquid form as cash reserve or call loans.[2]

Advantages and Disadvantages of the Canadian System.—Advantages claimed for the Canadian branch-banking system are, briefly, that it facilitates the transfer of funds from places where they are not needed to places where they are needed, that it permits the provision of safe and adequate banking facilities in small towns which could not support independent banks,[3] and, finally, that the large banks are safer than small independent banks even where such independent banks might be maintained otherwise. Certain disadvantages also are referred to, especially that managers of small branches lack knowledge of local needs and have power to deal upon their own authority with only minor or routine matters. It is further claimed, though not proved, that the system leads to a concentration of the "money power" in the hands of a few individuals.[3] In any case, there appears to be little complaint about such concentration as may exist.

FRANCE

Late Development.—The development of branch banking in France has been much more recent than in the other countries referred to above. As late as 1870, Walter Bagehot wrote:

> If a "branch," such as the National Provincial Bank opens in an English country town, were opened in a corresponding French one, it

[1] Breckinridge, "The Canadian Banking System, 1817–1890," p. 348.
[2] Ward, "The Canadian Banking System," p. 10.
[3] *Ibid.*, p. 5.

would not pay its expenses. You could not get any sufficient number of Frenchmen to agree to put their money there . . . Deposit banking is a very difficult thing to begin because people do not like to let their money out of their sight.[1]

Nevertheless, the branch-banking movement, even in France, was already underway. The great credit institutions of today were formed between the years 1859 and 1865.[2] These were the Crédit Lyonnais, the Société Générale, and the Crédit Industriel et Commercial. The Comptoir d'Escompte was founded even earlier. These four great banking institutions spread out a network of branches all over France and developed a discount-and-deposit type of banking in France. In the twenty-four years preceding 1885, their deposits increased sixfold.[2]

They preferred to discount short-term loans, and were indefatigable in putting the sight deposits intrusted to them into suitable investments.[3]

Failures.—The new type of banking did not proceed entirely without setbacks. Credit institutions were formed only to end in failure. The Crédit Mobilier failed in 1867; the Union Générale, in 1882; the Comptoir d'Escompte, in 1889; and the Société des Dépôts et Comptes Courantes, in 1891.[4]

Local Banks.—The local and provincial banks suffered from the energetic competition of the credit institutions, and many of them were absorbed by the larger institutions.[5] Nevertheless, some 2,700 of these small local banks managed to survive.[6] This survival is to be accounted for by two adjustments of the local banks to meet the competitive situation. In 1905, about 325 of the local banks formed a union under the name of the Société Centrale des Banques de Province for self-protection and to centralize provincial operations in Paris in order to obtain a share

[1] BAGEHOT, "Lombard Street," p. 77.

[2] LAUGHLIN, J. LAURENCE, "The Credit of the Nations," p. 146.

[3] *Ibid.*, p. 147.

[4] *Ibid.*, footnote.

[5] *Ibid.*, p. 147; PATRON, MAURICE, cited in PHILLIPS, "Readings," p. 492.

[6] LAUGHLIN, *op. cit.*, p. 147; ANDERSON, B. M., "Effects of the War on Money, Credit, and Banking in France and the United States," p. 26.

in the large dealings in securities.[1] This enabled the local banks to compete on a more nearly equal footing with the credit companies who did a great business in buying and selling securities. The second adjustment was in the form of greater specialization in the local business. To a peculiar and, perhaps, undue extent, the credit companies have tended to eliminate the personal element in extending credit to individuals at the branches.[2] Branch managers have been bound down by very rigid rules in regard to loans. The operations at the branches have been confined largely to two things: (1) selling to customers securities selected and recommended by the central office and (2) making the safest kind of discounts on short-term commercial bills.[3] This specialization of the credit companies left the field clear for the local banks to deal in loans to neighbors whose credit depended upon character and ability rather than collateral.[4] Moreover, the local banks also obtain business by granting longer-term credit than the credit companies allow.[4]

Significance of French Experience.—The French experience with branch banking is less significant for American guidance than that of Canada, Scotland, and England, since the French banks have emphasized the security-selling part of their business to such a great extent. That this emphasis is not inherent in the branch-banking business is indicated by the practices in the three other countries. The French banks have been criticized not only for selling securities and draining off local funds which would otherwise lead to local development but also for selling inferior European government securities at high profit.[5] One writer says:

> Branch banking cannot be recommended to America on the basis of French experience. Very much of our vigor and economic progress must be attributed to our many thousands of independent local banks.[6]

[1] LAUGHLIN, *op. cit.*, p. 147.

[2] PATRON, see PHILLIPS, "Readings," p. 492.

[3] ANDERSON, *op. cit.*, p. 40.

[4] PATRON, see PHILLIPS, "Readings," p. 493.

[5] ANDERSON, "Effects of the War on Money, Credit, and Banking in France and the United States," pp. 37–39.

[6] *Ibid.*, p. 39.

The same writer also says: "The French banks are much like bond houses in America, and handle virtually all of the security business of France."[1] The logical conclusion would seem to be a condemnation of bond houses, which, through their great hold on public confidence, may sell unsound securities, rather than a rejection of branch banking. Another conclusion might be that commercial banks should be denied the privilege of dealing in securities. However, none of these conclusions is necessary, for the most prized possession of any dealer in securities is his reputation, and mere business policy dictates the most careful selection of securities to preserve that reputation. Branch bankers can claim no exemption from this rule.

[1] *Ibid.*, p. 37.

CHAPTER XVIII

CONCLUSION

The preceding chapters have presented many facts about which theories may be woven and conclusions drawn. The writer has seen fit to present many of his conclusions directly in connection with his discussion of the pertinent facts. Nevertheless, it seems desirable to present certain more general observations about the desirability of branch banking in the United States and the probable future development.

Bank Failures.—There can be little doubt that the greatest evil in American banking is the frequency of bank failures with their large losses to depositors and stockholders. A number of the states in the Mississippi Valley have endeavored to provide relief from this evil through the passage of bank deposit guaranty laws, but the bank deposit guaranty systems set up have been unsuccessful in coping with the problem.

Not Prevented by Federal Reserve System.—Many of the evils of our system were removed by the inauguration of the Federal Reserve System. The Federal Reserve notes provide us with an elastic currency. The former decentralization of reserves and immobility of reserves are replaced by the system of concentrated reserves and ready movement of funds through the Federal Reserve banks. The domestic exchange system has been vastly improved, and exchange charges are common only in backward sections of the country. Nevertheless, the Federal Reserve Act did little to put an end to bank failures. When the act was being considered by Congress, a provision for guaranteeing bank deposits was at first included, but this provision was later eliminated. Contrary, therefore, to a common belief, the Federal Reserve banks do not "stand behind" member banks in case of failure, nor does the national government guarantee the safety of the national banks. So far as the inspection and supervision of member state banks has tended to improve the quality of state

banking, the Federal Reserve System may have helped in remedying the evil, but, unfortunately, failures of both state bank members and of national banks have continued altogether too common. It is true, of course, that the Federal Reserve System can help greatly where the assets of the bank are lacking in liquidity, but the great difficulty arises when it is the assets themselves and not their liquidity which is lacking. Here the Federal Reserve System has nothing to offer.

Waste.—A second evil in our present system is much less spectacular but nevertheless just as real. This evil is the evil of waste or economic inefficiency. In other words, our present unit banks carry on their work at too high a cost. The margin between interest, if any, to depositors and charges to borrowers is too great. The situation is analogous to many other economic phenomena to be observed on all sides. The unsound distribution of "bad debts" as part of the costs to be borne by cash buyers and those of good credit is being destroyed by the aggressive competition of the chain stores in the retail merchandising field. "Cash and carry" are now sharply contrasted with "credit and delivery," and the prices charged vary with the services rendered, though still, perhaps, not proportionally.

While it might be unfair to accuse the unit banks of inefficiency merely on the ground of failure to charge for specific services and to pay for specific benefits, compelling the valuable customers of the bank to "carry" the unprofitable, it is not unfair to say that unit banking has prevented that free mobility of commercial banking funds which would lead to their most profitable use; the small unit bank keeps funds unemployed or busy only at a low rate of interest when local demands for loans are low, because it lacks the necessary full information about possibilities elsewhere.

Branch Banking as a Remedy.—Branch banking constitutes a remedy for these evils, not in the sense that branch banking is a perfect thing, but simply that it is better than the existing order. The geographical division of labor which has brought into being the Corn Belt and the Cotton Belt and the other great regions of specialization has made the local bank an inescapably risky venture. Even a moderate adherence to sound investment principles requires that the individual with but a few thousands

to invest should attain a considerable diversification of his investment. Indeed, such an individual with moderate intelligence may easily buy such a range of securities as to insure himself definitely against any overwhelming loss. Yet, by our very laws, we have compelled the commercial banks of the country to forego this highly conservative policy of diversifying their committments unless they should turn from commercial loans to the purchase of securities. Could any rational person do otherwise than expect that many Iowa banks would fail when depression hits the Corn Belt? Bank failures due to improper concentration of risk are not merely probable, they are inevitable, as long as the system of unit banking prevails. Moreover, it may as well be admitted that state-wide branch banking will not afford a remedy for this situation; indeed, state-wide branch banking in some states where the specialization is most extreme might merely serve to make bad matters worse. As in all matters of insurance or risk bearing, the area covered must be of a sufficiently diverse character to give reasonable assurance that losses in one section will be offset by gains in another.

Branch banking makes possible the most economical use of the commercial banking funds of the country. Larger loans to deserving individuals may be made. The large branch-banking system may benefit itself and the country by more careful selection of securities for purchase. It is less ready to assist in the promotion of local projects which serve to gratify the pride of the community in their brief period of apparent prosperity and all too frequently bring ruin finally to many hard-working citizens. Moreover, branches may be established to meet the convenience of customers. Convenience, like time, means money to the customer. These branches, operated with a small force of employees and in an inexpensive building, serve a type of customer who would not think of dealing with an independent bank so scantily equipped; that is, the branch bank gives a service that the unit bank could not give at the same cost.

Branch Banking Uniformly Successful.—Although branch banking varies from country to country and from time to time, it has one persistent characteristic, the characteristic of success. The Scotch banks have been preeminently successful and command an impregnable position in the public esteem. The English

banks and the Canadian banks with their emphasis on the commercial type of banking, the French banks acting to a large extent as security merchants, and the California branch banks with their predominant interest in the savings business have all been highly successful both in returns to stockholders and in confidence of the public.

Predictions. *Rapid Increase in Branch Banks.*—For the future development in this country, certain predictions may be ventured. In general, the rapid growth of branch banking in the brief period since the year 1900 and the accelerating pace of that growth since the World War make it appear very certain that the number of branch banks will increase very rapidly in the future. The recent federal legislation contains nothing to provide more than the slightest check to this movement. It is true that state bank members of the Federal Reserve System are no longer to be permitted to establish out-of-the-city branches, even in those states where the state laws would permit this development. This provision may act as a temporary check to the development of state-wide branch banking in California, especially if the large member banks are able to control the state banking department so as to prevent the growth of non-member systems of branch banks. In the long run, it will probably prove ineffective even there, for the present situation gives the Bank of Italy altogether too privileged a position to be long tolerated by the other bankers of the state. In the South, where state-wide branch banking is permitted by law, the Federal Reserve System has so little influence that the prohibition of any kind of branches to Federal Reserve member banks would be likely merely to lessen Federal Reserve power in that section rather than to repress the branch-banking development.

Decline in Number of Unit Banks.—There will be a tendency for the number of unit banks to decline as the branch banks increase. This tendency may be fought by the unit bankers here, as it has been in France, through the organization of centralizing associations which will enable them to cooperate in the rendering of adequate service to the public. The unit bankers, now that their attempts at control of national legislation seem to have been frustrated, may seek reform through action of clearing houses or other cooperative means. The independent grocers, through

their alliances to meet chain-store competition, have set the example. If the unit local bank meets a real need for the personal type of service which it claims to render, it may well be able to survive in the face of the keenest branch-bank competition.

Weakening of Opposition to Branch Banking.—In view of the fact that the opposition to branch banking comes almost exclusively from the unit bankers, the continued growth of branch banking means an inevitable weakening of the opposition to branch banking. Indeed, branch banking, like short skirts and bobbed hair, is now so common as to be the "accepted thing" in nearly all of the large cities of the country. As the opposition weakens, it will be increasingly easier to obtain laws favorable to the development of branch banking in those states where branch banking now exists. In the states where branch banking is now prohibited and where a strong feeling of opposition to branch banking has been stirred up by and among the unit bankers, no immediate changes in the situation are to be expected. In the course of years, branch banking may be introduced either as a result of national legislation permitting national banks to establish branches in those states despite state prohibitions or as a result of the demand of business men who will become increasingly familiar with the advantages of branch banking as branch banking becomes the most familiar feature of banking in the large commercial centers. Unlike the unit bankers, the branch-bank groups have not manifested a tendency to force their system upon an unwilling constituency; therefore, it seems unlikely that they will seek to force through national legislation permitting national bank branches in states where the state laws do not permit state banks to have branches.

State Systems Have Proved Their Value.—There have been proposals to impose such a tax on state banks as to compel all of them to reincorporate as national associations. In the opinion of the writer, this would be a very undesirable action, for banking history since the Civil War shows great gains to the American banking system which have come from the diversity of laws and conditions permitted by freedom of the states in this matter. Savings departments, trust departments, and security departments were first developed and tried out in state institutions. The development of branch banking would have been deferred

many years, indeed, if it had been compelled to await favorable national legislation.

Profits Making Reformers' Dreams Come True.—The dream of the banking reformers is gradually coming true. Branch banking is now rendering great service to millions of American city dwellers and to some farmers. Its spread to country districts is only a matter of time. Those people who are interested in further improvement of our banking system have the greatest opportunity in educating the public and particularly the bankers in the advantages of branch banking. Just as in other phases of our present "acquisitive" society, the profits of the enterprisers constitute the powerful stimulus to change, but the public is the great gainer in the long run.

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[1] For a more comprehensive general list of books and articles, the reader is referred to the List of References on Branch Banking compiled by the Library of Congress, Division of Bibliography, under W. A. Seade, Chief Bibliographer, October 10, 1922. Obtainable in mimeograph form only.

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APPENDIX

Text of the McFadden Branch Banking Bill as passed by Congress and signed by the President, Feb. 25, 1927

An Act to further amend the national banking laws and the Federal Reserve Act, and for other purposes.

Consolidations

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

That the Act entitled "An Act to provide for the consolidation of national banking associations," approved Nov. 7, 1918, be amended by adding at the end thereof a new section to read as follows:

"Sec. 3. That any bank incorporated under the laws of any State, or any bank incorporated in the District of Columbia, may be consolidated with a national banking association located in the same county, city, town, or village under the charter of such national banking association on such terms and conditions as may be lawfully agreed upon by a majority of the board of directors of each association or bank proposing to consolidate, and which agreement shall be ratified and confirmed by the affirmative vote of the shareholders of each such association or bank owning at least two-thirds of its capital stock outstanding, or by a greater proportion of such capital stock in the case of such State bank if the laws of the State where the same is organized so require, at a meeting to be held on the call of the directors after publishing notice of the time, place, and object of the meeting for four consecutive weeks in some newspaper of general circulation published in the place where the said association or bank is situated, and in the legal newspaper for the publication of legal notices or advertisements, if any such paper has been designated by the rules of a court in the county where such association or bank is situated, and if no newspaper is published in the place, then in a paper of general circulation published nearest thereto, unless such notice of meeting is waived in writing by all stockholders of any such association or bank, and after sending such notice to each shareholder of record by registered mail at least ten days prior to said meeting, but any additional notice shall be given to the shareholders of such State bank which may be required by the laws of the State where the same is organized. The capital stock of such consolidated association shall not be less than that required under existing law for the organization of a national banking association in the place in which such consolidated association is located; and all the rights, franchises, and interests of such State or District bank so consolidated with a national banking association in and to every species of property, real, personal, and mixed, and choses in action thereto belonging, shall be

deemed to be transferred to and vested in such national banking association into which it is consolidated without any deed or other transfer, and the said consolidated national banking association shall hold and enjoy the same and all rights of property, franchises, and interests including the right of succession as trustee, executor, or in any other fiduciary capacity in the same manner and to the same extent as was held and enjoyed by such State or District bank so consolidated with such national banking association. When such consolidation shall have been effected and approved by the comptroller any shareholder of either the association or of the State or District bank so consolidated, who has not voted for such consolidation, may give notice to the directors of the consolidated association within 20 days from the date of the certificate of approval of the comptroller that he dissents from the plan of consolidation as adopted and approved, whereupon he shall be entitled to receive the value of the shares so held by him, to be ascertained by an appraisal made by a committee of three persons, one to be selected by the shareholder, one by the directors of the consolidated association, and the third by the two so chosen; and in case the value so fixed shall not be satisfactory to such shareholder he may within five days after being notified of the appraisal appeal to the comptroller of the Currency, who shall cause a reappraisal to be made, which shall be final and binding; and the consolidated association shall pay the expenses of reappraisal, and the value as ascertained by such appraisal or reappraisal shall be deemed to be a debt due and shall be forthwith paid to said shareholder by said consolidated association, and the shares so paid for shall be surrendered and, after due notice, sold at public auction within 30 days after the final appraisement provided for in this Act; and if the shares so sold at public auction shall be sold at a price greater than the final appraised value, the excess in such sale price shall be paid to the said shareholder; and the consolidated association shall have the right to purchase such shares at public auction, if it is the highest bidder therefor, for the purpose of reselling such shares within 30 days thereafter to such person or persons and at such price as its board of directors by resolution may determine. The liquidation of such shares of stock in any State bank shall be determined in the manner prescribed by the law of the State in such cases if such provision is made in the State law; otherwise as hereinbefore provided. No such consolidation shall be in contravention of the law of the State under which such bank is incorporated.

"The words 'State bank,' 'State banks,' 'bank,' or 'banks,' as used in this Section, shall be held to include trust companies, savings banks, or other such corporations or institutions carrying on the banking business under the authority of State laws."

Sec. 2. (*a*) That Section 5136 of the Revised Statutes of the United States, subsection "second" thereof as amended, be amended to read as follows:

"Second. To have succession from the date of the approval of this Act, or from the date of its organization if organized after such date of approval until such time as it be dissolved by the act of its shareholders owning two-

thirds of its stock, or until its franchise becomes forfeited by reason of violation of law, or until terminated by either a general or a special Act of Congress or until its affairs be placed in the hands of a receiver and finally wound up by him."

Buying and Selling Investment Securities

(*b*) That Section 5136 of the Revised Statutes of the United States, subsection "seventh" thereof, be further amended by adding at the end of the first paragraph thereof the following:

"*Provided*, That the business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse marketable obligations evidencing indebtedness of any person, co-partnership, association, or corporation, in the form of bonds, notes, and/or debentures, commonly known as investment securities, under such definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency, and the total amount of such investment securities of any one obligor or maker held by such association shall at no time exceed 25% of the amount of the capital stock of such association actually paid in and unimpaired and 25% of its unimpaired surplus fund, but this limitation as to total amount shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or obligations issued under authority of the Federal Farm Loan Act: *And provided further*, that in carrying on the business commonly known as the safe-deposit business no such association shall invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15% of the capital stock of such association actually paid in and unimpaired and 15% of its unimpaired surplus, so that the subsection as amended shall read as follows:

"Seventh. To exercise by its board of directors, or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title: *Provided*, That the business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse marketable obligations evidencing indebtedness of any person, co-partnership, association or corporation, in the form of bonds, notes and/or debentures, commonly known as investment securities, under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency, and the total amount of such investment securities of any one obligor or maker held by such association shall at no time exceed 25% of the capital stock of such association actually paid in and unimpaired and 25% of its unimpaired surplus fund, but this limitation as to total amount shall not apply to obligations of the United States, or general obligations

of any State or of any political subdivision thereof, or obligations issued under authority of the Federal Farm Loan Act: *And provided further*, That in carrying on the business commonly known as the safe-deposit business no such association shall invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15% of the capital stock of such association actually paid in and unimpaired and 15% of its unimpaired surplus.

"But no association shall transact any business except such as is incidental, and necessarily preliminary to its organization, until it has been authorized by the Comptroller of the Currency to commence the business of banking."

Sec. 3. That Section 5137 of the Revised Statutes of the United States, subsection "first" thereof, be amended to read as follows:

"First. Such as shall be necessary for its accomodation in the transaction of its business."

Capital Requirements of National Banks

Sec. 4. That Section 5138 of the Revised Statutes of the United States, as amended, be amended to read as follows:

"Sec. 5138. No national banking association shall be organized with a less capital than $100,000, except that such associations with a capital of not less than $50,000 may, with the approval of the Secretary of the Treasury, be organized in any place the population of which does not exceed 6,000 inhabitants, and except that such associations with a capital of not less than $25,000 may, with the sanction of the Secretary of the Treasury, be organized in any place the population of which does not exceed 3,000 inhabitants. No such association shall be organized in a city the population of which exceeds 50,000 persons with a capital of less than $200,000, except that in the outlying districts of such a city where the State laws permit the organization of State banks with a capital of $100,000 or less, national banking associations now organized or hereafter organized may, with the approval of the Comptroller of the Currency, have a capital of not less than $100,000."

Provisions Governing Increase in Capital

Sec. 5. That Section 5142 of the Revised Statutes of the United States, be amended to read as follows:

"Sec. 5142. Any national banking association may, with the approval of the Comptroller of the Currency, and by a vote of shareholders owning two-thirds of the stock of such associations, increase its capital stock to any sum approved by the said comptroller, but no increase in capital shall be valid until the whole amount of such increase is paid in and notice thereof, duly acknowledged before a notary public by the president, vice-president, or cashier of said association, has been transmitted to the Comptroller of the Currency and his certificate obtained specifying the amount of such increase in capital stock and his approval thereof, and that it has been duly paid in as part of the capital of such association: *Provided*, however, That a national banking association may, with the approval of the Comptroller of the

Currency, and by the vote of shareholders owning two-thirds of the stock of such association, increase its capital stock by the declaration of a stock dividend, provided that the surplus of said association, after the approval of the increase, shall be at least equal to 20% of the capital stock as increased. Such increase shall not be effective until a certificate certifying to such declaration of dividend, signed by the president, vice-president or cashier of said association and duly acknowledged before a notary public, shall have been forwarded to the Comptroller of the Currency and his certificate obtained specifying the amount of such increase of capital stock by stock dividend, and his approval thereof."

Chairman of Board

Sec. 6. That Section 5150 of the Revised Statutes of the United States be amended to read as follows:

"Sec. 5150. The president of the bank shall be a member of the board and shall be the chairman thereof, but the board may designate a director in lieu of the president to be chairman of the board, who shall perform such duties as may be designated by the board."

Operation of Branches

Sec. 7. That Section 5155 of the Revised Statutes of the United States be amended to read as follows:

"Sec. 5155. The conditions upon which a national banking association may retain or establish and operate a branch or branches are the following:

"*(a)* A national banking association may retain and operate such branch or branches as it may have in lawful operation at the date of the approval of this Act, and any national banking association which has continuously maintained and operated not more than one branch for a period of more than 25 years immediately preceding the approval of this Act may continue to maintain and operate such branch.

"*(b)* If a State bank is hereafter converted into or consolidated with a national banking association, or if two or more national banking associations are consolidated, such converted or consolidated association may, with respect to any of such banks, retain and operate any of their branches which may have been in lawful operation by any bank at the date of the approval of this Act.

"*(c)* A national banking association may, after the date of the approval of this Act establish, and operate new branches within the limits of the city, town, or village in which said association is situated if such establishment and operation are at the time permitted to State banks by the law of the State in question.

"*(d)* No branch shall be established after the date of the approval of this Act within the limits of any city, town, or village of which the population by the last decennial census was less than 25,000. No more than one such branch may be thus established where the population, so determined, of such municipal unit does not exceed 50,000; and not more than two such branches

where the population does not exceed 100,000. In any such municipal un where the population exceeds 100,000 the determination of the number (branches shall be within the discretion of the Comptroller of the Currency

"(*e*) No branch of any national banking association shall be establishe or moved from one location to another without first obtaining the consen and approval of the Comptroller of the Currency.

"(*f*) The term 'branch' as used in this section shall be held to include an branch bank, branch office, branch agency, additional office, or any branc place of business located in any State or Territory of the United States or i the District of Columbia at which deposits are received, or checks paid, o money lent.

"(*g*) This section shall not be construed to amend or repeal Section 25 c the Federal Reserve Act, as amended, authorizing the establishment b national banking associations of branches in foreign countries, or dependen cies, or insular possessions of the United States.

"(*h*) The words 'State bank,' 'State banks,' 'bank,' or 'banks,' as use in this section shall be held to include trust companies, savings banks, o other such corporations or institutions carrying on the banking busines under the authority of State laws."

Sec. 8. That Section 5190 of the Revised Statutes of the United State be amended to read as follows:

"Sec. 5190. The general business of each national banking associatio shall be transacted in the place specified in its organization certificate and in the branch or branches, if any, established or maintained by it in accordanc with the provisions of Section 5155 of the Revised Statutes, as amended by this Act."

Sec. 9. That the first paragraph of Section 9 of the Federal Reserve Act be amended so as to read as follows:

"Sec. 9. Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, desiring t become a member of the Federal reserve system, may make application t the Federal Reserve Board, under such rules and regulations as it ma prescribe, for the right to subscribe to the stock of the Federal reserve bank organized within the district in which the applying bank is located. Such application shall be for the same amount of stock that the applying bank would be required to subscribe to as a national bank. The Federal Reserve Board, subject to the provisions of this Act and to such conditions as it ma prescribe pursuant thereto may permit the applying bank to become a stock-holder of such Federal reserve bank.

"Any such State bank which, at the date of the approval of this Act has established and is operating a branch or branches in conformity with th State law, may retain and operate the same while remaining or upon becom-ing a stockholder of such Federal reserve bank; but no such State bank ma retain or acquire stock in a Federal reserve bank except upon relinquish-ment of any branch or branches established after the date of the approva of this Act beyond the limits of the city, town, or village in which the paren bank is situated."

Obligations Limited to 10 Per Cent of Capital

Sec. 10. That Section 5200 of the Revised Statutes of the United States, as amended, be amended to read as follows:

"Sec. 5200. The total obligations to any national banking association of any person, co-partnership, association, or corporation shall at no time exceed 10 % of the amount of the capital stock of such association actually paid in and unimpaired and 10 % of its unimpaired surplus fund. The term 'obligations' shall mean the direct liability of the maker or acceptor of paper discounted with or sold to such association and the liability of the indorser, drawer, or guarantor who obtains a loan from or discounts paper with or sells paper under his guaranty to such association and shall include in the case of obligations of a co-partnership or association the obligations of the several members thereof. Such limitation of 10 % shall be subject to the following exceptions:

"(1) Obligations in the form of drafts or bills of exchange drawn in good faith against actually existing values shall not be subject under this section to any limitation based upon such capital and surplus.

"(2) Obligations arising out of the discount of commercial or business paper actually owned by the person, co-partnership, association, or corporation negotiating the same shall not be subject under this section to any limitation based upon such capital and surplus.

"(3) Obligations drawn in good faith against actually existing values and secured by goods or commodities in process of shipment shall not be subject under this section to any limitation based upon such capital and surplus.

"(4) Obligations as indorser or guarantor of notes, other than commercial or business paper excepted under (2) hereof, having a maturity of not more than six months, and owned by the person, corporation, association, or co-partnership indorsing and negotiating the same, shall be subject under this section to a limitation of 15 % of such capital and surplus in addition to such 10 % of such capital and surplus.

"(5) Obligations in the form of banker's acceptances of other banks of the kind described in Section 13 of the Federal Reserve Act shall not be subject under this section to any limitation based upon such capital and surplus.

"(6) Obligations of any person, co-partnership, association, or corporation, in the form of notes or drafts secured by shipping documents, warehouse receipts or other such documents transferring or securing title covering readily marketable non-perishable staples when such property is fully covered by insurance, if it is customary to insure such staples, shall be subject under this section to a limitation of 15 % of such capital and surplus in addition to such 10 % of such capital and surplus when the market value of such staples securing such obligation is not at any time less than 115 % of the face amount of such obligation, and to an additional increase of limitation of 5 % of such capital and surplus in addition to such 25 % of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 120 % of the face amount of such additional obligation, and to a further additional increase of limitation of 5 %

of such capital and surplus in addition to such 30% of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 125% of the face amount of such additional obligation, and to a further additional increase of limitation of 5% of such capital and surplus in addition to such 35% of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 130% of the face amount of such additional obligation, and to a further additional increase of limitation of 5% of such capital and surplus in addition to such 40% of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 135% of the face amount of such additional obligation, and to a further additional increase of limitation of 5% of such capital and surplus in addition to such 45% of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 140% of the face amount of such additional obligation, but this exception shall not apply to obligations of any one person, co-partnership, association or corporation arising from the same transactions and/or secured upon the identical staples for more than ten months.

Live Stock Obligations

"(7) Obligations of any person, co-partnership, association, or corporation in the form of notes or drafts secured by shipping documents or instruments transferring or securing title covering livestock or giving a lien on livestock when the market value of the livestock securing the obligation is not at any time less than 115% of the face amount of the notes covered by such documents shall be subject under this section to a limitation of 15% of such capital and surplus in addition to such 10% of such capital and surplus.

"(8) Obligations of any person, co-partnership, association, or corporation in the form of notes secured by not less than a like amount of bonds or notes of the United States issued since April 24, 1917, or certificates of indebtedness of the United States, shall (except to the extent permitted by rules and regulations prescribed by the Comptroller of the Currency, with the approval of the Secretary of the Treasury) be subject under this section to a limitation of 15% of such capital and surplus in addition to such 10% of such capital and surplus."

Sec. 11. That Section 5202 of the Revised Statutes of the United States as amended be amended by adding at the end thereof a new paragraph to read as follows:

"Eighth. Liabilities incurred under the provisions of Section 202 of Title II of the Federal Farm Loan Act, approved July 17, 1916, as amended by the Agricultural Credits Act of 1923."

Certification of Checks

Sec. 12. That Section 5208 of the Revised Statutes of the United States as amended be amended by striking out the words "or who shall certify a check before the amount thereof shall have been regularly entered to the

credit of the drawer upon the books of the bank," and in lieu thereof inserting the following: "or who shall certify a check before the amount thereof shall have been regularly deposited in the bank by the drawer thereof," so that the section as amended shall read as follows:

"Sec. 5208. It shall be unlawful for any officer, director, agent, or employee of any Federal reserve bank, or any member bank as defined in the Act of Dec. 23, 1913, known as the Federal Reserve Act, to certify any check drawn upon such Federal reserve bank or member bank unless the person, firm, or corporation drawing the check has on deposit with such Federal reserve bank or member bank, at the time such check is certified, an amount of money not less than the amount specified in such check. Any check so certified by a duly authorized officer, director, agent, or employee shall be a good and valid obligation against such Federal reserve bank or member bank; but the act of any officer, director, agent, or employee of any such Federal reserve bank or member bank in violation of this section shall, in the discretion of the Federal Reserve Board, subject such Federal reserve bank to the penalties imposed by Section 11, subsection (*h*) of the Federal Reserve Act, and shall subject such member bank, if a national bank, to the liabilities and proceedings on the part of the Comptroller of the Currency provided for in Section 5234, Revised Statutes, and shall, in the discretion of the Federal Reserve Board, subject any other member bank to the penalties imposed by Section 9 of said Federal Reserve Act for the violation of any of the provisions of said Act. Any officer, director, agent or employee of any Federal reserve bank or member bank who shall wilfully, violate the provisions of this section, or who shall resort to any device, or receive any fictitious obligation, directly or collaterally, in order to evade the provisions thereof, or who shall certify a check before the amount thereof shall have been regularly deposited in the bank by the drawer thereof, shall be deemed guilty of a misdemeanor and shall, on conviction thereof in any district court of the United States, be fined not more than $5,000, or shall be imprisoned for not more than five years, or both, in the discretion of the court."

Reports to Comptroller of Currency

Sec. 13. That Section 5211 of the Revised Statutes of the United States as amended be amended to read as follows:

"Sec. 5211. Every association shall make to the Comptroller of the Currency not less than three reports during each year, according to the form which may be prescribed by him, verified by the oath or affirmation of the president, or of the cashier, or of a vice president or of an assistant cashier of the association designated by its board of directors to verify such reports in the absence of the president and cashier, taken before a notary public properly authorized and commissioned by the State in which such notary resides and the association is located, or any other officer having an official seal, authorized in such State to administer oaths, and attested by the signature of at least three of the directors. Each such report shall exhibit, in detail and under appropriate heads, the resources and liabilities of the

association at the close of business on any past day by him specified, and shall be transmitted to the comptroller within five days after the receipt of a request or requisition therefor from him; and the statement of resources and liabilities, together with acknowledgement and attestation in the same form in which it is made to the comptroller, shall be published in a newspaper published in the place where such association is established, or if there is no newspaper in the place, then in the one published nearest thereto in the same county, at the expense of the association; and such proof of publication shall be furnished as may be required by the comptroller. The comptroller shall also have power to call for special reports from any particular association whenever in his judgment the same are necessary in order to obtain a full and complete knowledge of its condition."

Loans or Gratuities to Bank Examiners Prohibited

Sec. 14. That Section 22 of the Federal Reserve Act, subsection (*a*), paragraph 2 thereof, be amended to read as follows:

"(*a*) No member bank and no officer, director, or employee thereof shall hereafter make any loan or grant any gratuity to any bank examiner. Any bank officer, director, or employee violating this provision shall be deemed guilty of a misdemeanor and shall be imprisoned not exceeding one year, or fined not more than $5,000, or both, and may be fined a further sum equal to the money so loaned or gratuity given.

"Any examiner or assistant examiner who shall accept a loan or gratuity from any bank examined by him, or from an officer, director, or employee thereof, or who shall steal, or unlawfully take, or unlawfully conceal any money, note, draft, bond, or security or any other property of value in the possession of any member bank or from any safe deposit box in or adjacent to the premises of such bank, shall be deemed guilty of a misdemeanor and shall, upon conviction thereof in any district court of the United States, be imprisoned for not exceeding one year, or fined not more than $5,000, or both, and may be fined a further sum equal to the money so loaned, gratuity given, or property stolen, and shall forever thereafter be disqualified from holding office as a national bank examiner."

Loans on Real Estate

Sec. 15. That Section 24 of the Federal Reserve Act be amended to read as follows:

"Sec. 24. Any national banking association may make loans secured by first lien upon improved real estate, including improved farm land, situated within its Federal reserve district or within a radius of one hundred miles of the place in which such bank is located, irrespective of district lines. A loan secured by real estate within the meaning of this section shall be in the form of an obligation or obligations secured by mortgage, trust deed, or other such instrument upon real estate when the entire amount of such obligation or obligations is made or is sold to such association. The amount of any such loan shall not exceed 50% of the actual value of the real estate

offered for security, but no such loan upon such security shall be made for a longer term than five years. Any such bank may make such loans in an aggregate sum including in such aggregate any such loans on which it is liable as indorser or guarantor or otherwise equal to 25% of the amount of the capital stock of such association actually paid in and unimpaired and 25% of its unimpaired surplus fund, or to one-half of its savings deposits, at the election of the association, subject to the general limitation contained in Section 5200 of the Revised Statutes of the United States. Such banks may continue hereafter as heretofore to receive time and savings deposits and to pay interest on the same, but the rate of interest which such banks may pay upon such time deposits or upon savings or other deposits shall not exceed the maximum rate authorized by law to be paid upon such deposits by State banks or trust companies organized under the laws of the State wherein such national banking association is located."

Par Value of National Bank Stock

Sec. 16. That Section 5139 of the Revised Statutes of the United States be amended by inserting in the first sentence thereof the following words: "or into shares of such less amount as may be provided in the articles of association" so that the section as amended shall read as follows:

"Sec. 5139. The capital stock of each association shall be divided into shares of $100 each, or into shares of such less amount as may be provided in the articles of association, and be deemed personal property, and transferable on the books of the association in such manner as may be prescribed in the by-laws or articles of association. Every person becoming a shareholder by such transfer shall, in proportion to his shares, succeed to all rights and liabilities of the prior holder of such shares; and no change shall be made in the articles of association by which the rights, remedies, or security of the existing creditors of the association shall be impaired."

Minimum Holdings of Directors

Sec. 17. That Section 5146 of the Revised Statutes of the United States as amended be amended by inserting in lieu of the second sentence thereof the following: "Every director must own in his own right shares of the capital stock of the association of which he is a director the aggregate par value of which shall not be less than $1,000, unless the capital of the bank shall not exceed $25,000 in which case he must own in his own right shares of such capital stock the aggregate value of which shall not be less than $500," so that the section as amended shall read as follows:

"Sec. 5146. Every director must during his whole term of service, be a citizen of the United States, and at least three-fourths of the directors must have resided in the State, Territory, or District in which the association is located, or within fifty miles of the location of the office of the association, for at least one year immediately preceding their election, and must be residents of such State or within a fifty-mile territory of the location of the association during their continuance in office. Every director must own

in his own right shares of the capital stock of the association of which he is a director the aggregate par value of which shall not be less than $1,000, unless the capital of the bank shall not exceed $25,000 in which case he must own in his own right shares of such capital stock the aggregate par value of which shall not be less than $500. Any director who ceases to be the owner of the required number of shares of the stock, or who becomes in any other manner, disqualified, shall thereby vacate his place."

FEDERAL RESERVE BANKS CHARTERED FOR INDETERMINATE PERIOD

Sec. 18. That the second subdivision of the fourth paragraph of Section 4 of the Federal Reserve Act be amended to read as follows:

"Second. To have succession after the approval of this Act until dissolved by Act of Congress or until forfeiture of franchise for violation of law."

DISCONTINUANCE OF RESERVE BANK BRANCHES

Sec. 19. That Section 3 of the Federal Reserve Act, as amended, is further amended by adding at the end thereof the following:

"The Federal Reserve Board may at any time require any Federal Reserve Bank to discontinue any branch of such Federal Reserve Bank established under this section. The Federal Reserve Bank shall thereupon proceed to wind up the business of such branch bank, subject to such rules and regulations as the Federal Reserve Board may prescribe."

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Alfred J. Blasco